ASSOCIATION OF CONSULTING ACTUARIES

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Value for Money Team
DWP

Dear All

Consultation: Value for Money: A framework on metrics, standards, and disclosures

I am writing on behalf of the **Association of Consulting Actuaries** in response to the above consultation. Our answers to your specific questions are set out on the following pages, and we summarise our key points below:

- We are very supportive of the ambition of the joint consultation. Value for money (VFM) is an essential component of good member outcomes, and we are pleased to see the holistic breadth of the proposals, covering areas beyond just costs and charges.
- In our view, the aims should be to raise the bar on expectations to improve member value in all areas, and to equip boards with the appropriate data to assess value.
- We welcome the proposed inclusion of the quality of member communications and other services within the VFM framework. Elevating the assessments beyond a pure cost focus will help to reduce the risks around a "race to the bottom" on charges.
- However, there is a potential conflict in that the proposed approach of including *all costs* within administration costs in the assessment (as defined… "By this we mean the amount spent on anything other than investment"). This creates the possibility of VFM requirements triggering a reduction in VFM initiatives to manage costs, stifling innovation and leading to worse outcomes for members. We note that the consultation does state that further clarification will be provided in relation to how certain costs are defined. We believe this is essential.
- There remains a culture of opaqueness and complexity on charges for decumulation products, that needs to be dismantled. We strongly support the desire in the second phase of roll-out to expand the new requirements to decumulation (and other) vehicles. Decumulation arrangements presents a particular area of concern to us, as there is potential for significant erosion of value at the point of, and beyond, retirement.

We would be happy to discuss our response further if that is helpful. In that event, please contact me on 07557 031198 or at tessa.page@mercer.com.

Yours sincerely

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

Disclaimer

Consultation Questions: Consultation on Value for Money: A framework on metrics, standards and disclosures

Name of respondent/s / organisation (please provide):

Association of Consulting Actuaries (ACA)

Pension Scheme type(s) (please cross all those that apply)	
Master Trust (500 or more employers approx.)	
Master Trust (fewer than 500 employers)	
Single-employer trust-based defined contribution (DC) workplace pension scheme	
Contract-based DC workplace pension scheme (500 or more employers approx.)	
Contract-based DC workplace pension scheme (fewer than 500 employers)	
Contract-based DC non workplace pensions	
Defined benefit pension scheme	
Hybrid pension scheme	
Your role (please cross all those that apply)	
DC pension scheme trustee or manager	
Member of Independent Governance Committee (IGC) or Governance Advisory Arrangement (GAA)	
Administrator	
Investment consultant	
Financial advisor	
Employer	
Employee benefit consultant	x
Consumer organisation	
Law firm	
Pension saver	
Other (please state)	Industry body

Chapter 3: Scope, criteria, and outcomes

Question 1: Do you agree with the proposed phased approach?

Yes – in our view the proposed approach to start with default arrangements for workplace pensions will allow the new VFM framework to target a large proportion of pension savers and assets under management in the first phase and allow testing and refinement before rolling out more widely. In particular:

- We support the inclusion of legacy schemes in the first phase as we acknowledge these can often lack investment and engagement by governance bodies and pension providers as employers tend to focus on their current employees.
- We note that a small proportion of legacy schemes have unique benefits to members (e.g. defined benefit / GMP underpins or guaranteed annuity rates). If these are to be included in phase one there would need to be consideration of how these additional benefits can be measured, not least as they can present challenges to consolidation into alternative arrangements (if a poor value conclusion is reached). Perhaps a "yes" or "no" (1 or 0 score) to indicate the existence of such benefits if they have a material positive impact on members.

We acknowledge and support the desire in the second phase to expand to self-select, non-workplace and decumulation vehicles. The latter arrangements presents 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.

We hope as this consistent VFM approach becomes embedded, communication to employers and in time members will help hold providers, trustees and governance committees to account.

Chapter 4: Investment performance

Question 2: Do you agree with our focus on and approach to developing backward-looking investment performance metrics?

The proposed performance review periods of 1, 3, 5 and 10, 15 years (where available) appear sensible to us, although it would be extremely rare to find a default arrangement in particular that has not been changed over this period (and therefore, the past is even less likely to be a good indication of future prospects).

As regards the proposed age ranges for member cohorts (25, 45, 55 and State Pension Age), we note that a number of default arrangements do not start lifestyle (or target date fund) de-risking until after age 55 or indeed, until members are within 5 years of their selected retirement age. We therefore suggest that performance data at certain older ages is also collected (3 years prior to retirement would represent a good balance).

We would like clarification on what appears to be the proposed "net of **all** costs" approach to be adopted - for example, are all expenses of running a scheme to be included? This would include not only administration costs but also investment, legal, and other advisory costs, trustee costs, communications costs, etc. In many situations these costs are paid for by the employer. While not explicitly stated in the consultation, the underlying philosophy here would appear to be one of comparing what was provided by the plan (i.e. investment return) versus what was paid in order to earn it (i.e. total scheme costs). Our concerns here are:

- An "all costs" netting approach may drive behaviour such that governance bodies might be reluctant to invest in improved/more expensive member services unrelated to investment returns as that would ultimately reduce the scheme's performance net of all costs.
- Many non-investment related services (and costs) may be shared with defined benefit sections for hybrid schemes, or across schemes for employers and master trusts with multiple arrangements. A large employer may for example have several legacy DB schemes, a hybrid scheme, and an open DC arrangement, all with a shared administrator who charges an "all in" fee that is not broken down between schemes.

We note that the consultation does state that further clarification will be provided in relation to how certain costs are defined. We believe this is essential to enable industry participants to comment more meaningfully on the proposals.

Question 3: Do you agree with our proposals to use Maximum Drawdown and/or ASD as risk-based metrics for each reporting period and age cohort?

Yes, we believe these are sensible metrics that will be reasonably familiar to well-governed schemes. We do note however that chain-linking risk metrics is more challenging than chain-linking investment returns, so clarity on requirements in the at regard would be helpful.

To facilitate like-for-like comparisons, we would like to see standardisation of the calculation methodology for these metrics (e.g. whether ASD should be based on daily price points or monthly).

We are pleased to note that there is recognition that ASD may be less effective for private market and less liquid investments (given the more sporadic valuation points of these assets, which can be subject to time lags). Provided there is flexibility in the framework such that these assets can be considered in both quantitative and qualitative terms, we are comfortable with the approach.

For private market and alternative investments we consider that governance bodies should also have a firm eye on liquidity metrics as an assessment of risk, for example the proportion of the portfolio that could be realised within 1 day, 1 week, 1 month, etc, along with the level of cashflow/redemptions vs any gate levels.

Question 4: Do you agree with our proposals on “chain-linking” data on past historic performance where changes have been made to the portfolio composition or strategy of the default arrangement?

Typically a change 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.

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.

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

Question 5: Do you agree with proposals for the additional disclosure of returns net of investment charges only?

We believe returns should be net of the total expense ratio (TER) that members pay, and net of transaction costs.

Question 6: Do you agree with requiring disclosure of asset allocation under the eight existing categories for all in-scope default arrangements?

We are comfortable with this and believe it will provide helpful context when comparing different investment performance and costs, though in the interests of proportionality, we suggest that such disclosures do not form part of the VFM assessment covering self-select funds.

Question 7: Do you think we should require a forward-looking performance and risk metric, and if so, which model would you propose and why?

Forward-looking metrics are helpful as part of strategy reviews and should be encouraged for inclusion in triennial default strategy reviews in particular.

However, given their subjective nature and the not insignificant costs associated with regularly commissioning stochastic or deterministic modelling analysis, we believe these measures have less of a role in an annual Value for Money assessments. Certain schemes, including master trusts and contract based arrangements, might be incentivised for commercial reasons to show the highest possible future return.

If forward looking metrics are to be required, we would support consistency in the setting of assumptions (perhaps linked to the new TM1 SMPI requirements / pensions dashboards projection assumptions) to avoid confusion and facilitate comparisons.

Chapter 5: Costs and charges

Question 8: Are there any barriers to separating out charges in order to disclose the amount paid for services?

Currently many bundled providers do not separate these, and this has been a source of frustration for governance bodies, as it can be hard to accurately identify which aspects of charges are not delivering value ("is the investment manager expensive, or is the administration fee the problem?"). We would like to see changes such that providers are obliged to report this information.

We think there is merit in a member being able to see the value of what the employer pays, and so also question if the disclosure of total charges rather than 'member borne' charges will limit this.

Question 9: Do you have any suggestions for converting combination charges into an annual percentage? How would you address charging structures for legacy schemes?

We agree with the principle to convert combination charges into an annual percentage, to enable comparability between schemes. However, the additional guidance should be clear on how the single figure will be calculate, as schemes may be using different assumptions / methods and then they would not be comparable any more.

Question 10: Do you agree with our proposal to provide greater transparency where charging levels vary by employer? Do you agree that this is best achieved by breaking down into cohorts of employers or would it be sufficient to simply state the range of charges?

We agree in principle to provide greater transparency where charging levels vary by employer. The cohorts of employers by size should be consistent across providers, to avoid providers strategically selecting their cohorts to appear better value.

Simply stating the range of charges will not provide sufficient information to allow meaningful comparison.

Typically employers with larger AUM will achieve lower costs for members than smaller schemes, given the willingness of provider to win and maintain large AUM. Showing the charges by cohorts of employers will provide greater transparency, and also ability to more consistently compare charges across similar sized schemes whilst this difference in pricing levels remains.

The transparency may also support smaller-sized employers to be able to negotiate and put pressure on providers to offer more consistent pricing if the costs and charges are disclosed by cohort.

We would be keen to see guidance on how bespoke default investment strategies within Master Trusts and contract-based arrangements will be reported on. Some employers choose a bespoke default, as they will wish to align the pension scheme to their own corporate strategy (e.g ESG alignment) or broader investment beliefs.

Chapter 6: Quality of services

Question 11: Are these the right metrics to include as options for assessing effective communications? Are there any other communication metrics that are readily quantifiable and comparable that would capture service to vulnerable or different kinds of savers?

We note the desire to keep the assessment against measures that are quantifiable which is important to enable comparisons across schemes.

We have some comments when considering the proposed metrics in turn:

- % of members who update retirement ages: we do not believe this is necessarily a good indication of the quality of the communication as members who are happy with the default retirement age will have taken no action because they do not want a change to be made, not due to lack of engagement. We also discourage the use of “retirement age” as this may differ from the age at which members intend to withdraw benefits.
- % of members who have completed an expression of wish form: this is generally a good measure for overall engagement from members. Inclusion of this may lead to a focused push from providers to improve this score purely to improve their VFM but in our opinion this would be a good unintended consequence as there is a worryingly low completion rate across the industry.
- Member survey – as some providers do not measure NPS we believe this should be encouraged, though we note that for smaller schemes the sample size can be very low and therefore results can be dominated by a small handful of events. The survey approach (response rate and score) would be very useful especially if there is small number of standard questions.

Other quantifiable measures to consider are the open/click rate of annual benefit statements, the availably of an App/website to view fund values and the unique user % logins to these.

Question 12: Are these the right metrics to include as options for assessing the effectiveness of administration and/or are there any other areas of administration that are readily quantifiable and comparable?

We note there are others in the industry more directly involved in administration who are better placed to answer this question.

The one point we would make is that we come across different Service Level Agreements across the schemes we advise. If the benchmark is to measured against scheme specific SLAs there would need to be push for consistency across SLAs for the core financial transactions that are being measured e.g. one provider may have an SLA of 10 days which they meet 100% of the time, another may have 5 days which they meet 95% of the time. Clearly this is an unfair comparison to make.

In summary we believe SLAs is a good starting point, but there should be guidance for a suitable SLA target for financially critical tasks.

We also note that many administrators of hybrid schemes do not break down reporting between those that are DB related and those that are DC related (in many cases, members will have both types of benefit in a single scheme). Therefore, the proposals will be difficult to implement in these cases.

Chapter 7: Disclosure templates and publication timings

Question 13: Do you agree with a decentralised or a centralised approach for the publication of the framework data? Do you have any other suggestions for the publication of the framework data?

A decentralised approach is very similar to what we have at the moment. This puts more pressure on the target audience to source their information from various websites. We recognise there is the disadvantage that the data may therefore be subject to more manipulation if a decentralised approach is taken and could result in less confidence in the data being sourced and used. However, we note this approach has worked to date.

Whilst a consolidator could improve the ease of access to consistent data across the industry by having all the information accessible in one place, we are concerned that this could also present a much larger risk if the consolidator is not well set up and maintained.

Question 14: Do you agree with the proposed deadlines for both the publication of the framework data and VFM assessment reports?

We agree with the principles of having a common date for the publication of data, as it would allow for more meaningful comparison. However, this will create capacity crunches for schemes, providers and advisers to produce the data and reports at the same time.

For example, an end of October deadline for publication may clash with other documents which need to be produced with seven months of a 31 March year end, such as report and accounts, chair's statement, implementation statement, TCFD .

We note changing year end where there is insufficient time between scheme year end and the October publication date can cause complexity (ignoring the capacity crunch this could lead to noted above). This may be of particular difficult for some schemes who may have their reporting aligned with wider company reporting, especially if the parent company is based overseas.

Chapter 8: Assessing Value for Money

Question 15: Do you think we should require comparisons against regulator-defined benchmarks or comparisons against other schemes and industry benchmarks?

We support a comparison against other schemes and industry benchmarks as this would naturally allow the benchmarks to evolve as the market and competition evolves. This approach should encourage schemes to regularly “up their game” as innovation, scale and increased focus on VFM improves the pensions provision across the industry

Question 16: Do you agree with the step-by-step process we have outlined, including the additional consideration?

Yes that proposed step by step approach seems logical and will enable a consistent approach across schemes.

Question 17: Do you agree with a ‘three categories’ / RAG rating approach for the result of the VFM assessment?

In principle yes, and the RAG rating approach reflects the methodology used by a number of our member firms when conducting VFM assessments for clients..

However we believe the three VFM outcomes are open to interpretation and a large proportion of schemes will end up in the second or third tier - with few in the first tier of ‘not VFM’ - due to the absence of mandated thresholds that must be met to achieve a VFM rating.

Question 18: How should we take into account the specific challenges of contract-based schemes while ensuring equivalent outcomes for pension savers?

IGCs could undertake a similar assessment to that of a Master Trust Board, however we note that the legislative limitation to move members without consent is currently a barrier that would prevent the majority of employers from taking action. Alternative actions could be considered such as mandatory communication to members to alert them that their scheme has not met VFM and instructions on how to move their funds if they want to.

We believe that legislation could be introduced to permit a ‘without consent’ transfer from a contract-based arrangement to a master trust, reflecting the rules currently in place for trust-based plans. The IGC should be the responsible party for effecting the transfer, although the rules should allow for consultation with employers, not least because they will likely use any successor arrangement as an auto enrolment vehicle.

The regulators should consider how former employees in a contract-based scheme that is assessed as poor value might have their savings transferred to a better value arrangement. We suggest that that is likely to be a matter for the IGC to address rather than the employer / sponsor.

Question 19: Do you agree with our proposals on next steps to take following VFM assessment results, including on communications?

In our view communicating VFM outcomes to employers would be an effective way to highlight and publicise the VFM results and hold Trustees/providers responsible for improvements to account. It would give employers opportunity to select a better scheme for their employees if the VFM assessment constantly falls short. Further consideration should also be given to what information is disclosed to members. Simplified, summary disclosures may be a better means of communication than publication of the assessment report and Chair's Statement (which experience suggests few members read). A disclosure that borrows some of the aims of the new simplified annual benefit statements might be helpful here.

Chapter 9: The VFM framework and Chair's Statement

Question 20: If the Chair's Statement was split into two separate documents, what information do you think would be beneficial in a member-facing document?

A consistent member facing document would enable members to compare across schemes and could be worded in a member-friendly way that pulls out the most relevant bits to a member. For example, members may be most interested in disclosure of costs and charges, Net Investment Returns, and a statement of whether the scheme is delivering value.

Question 21: Is there any duplication between the VFM framework proposals and current Chair's Statement disclosure requirements?

There appears to be overlap in some areas, particularly regarding the Net Investment Return disclosures, Common and Conditional Data, and elements of the Transaction Cost disclosures.

Chapter 10: FCA specific issues

Question 22: Should individual SIPP arrangements be excluded from the requirement on providers to establish an IGC/GAA and to publicly disclose costs and charges and, if so, under what circumstances?

We do not believe that individual SIPP arrangements should be excluded from the requirements mentioned above. We understand that one of the purposes of the VFM framework is to ensure consistency across the industry, and to increase competition and drive value. Requiring SIPP arrangements to establish and an IGC / GAA to then disclose costs and charges information may help achieve this policy intent.

Further we believe including SIPPs in the requirements may have the desired effect of mitigating the risk that pension savers seek to transfer from a workplace to a non-workplace pension without understanding how they compare in terms of VFM.

Question 23: Do you think there would be merit in a proposal to mandate the inclusion of a pension saver-focused summary alongside the IGC Chair's Report?

Yes, we agree that a pension saver-focused summary would simplify the information in the chair's report. This would reduce the risk that members do not misinterpret information in the IGC's Chair's Report, which can be lengthy and technical.

Question 24: Do you think the provider or the IGC should be responsible under FCA rules for the publication of framework data?

It may be simplest if the IGC is responsible for collation and publication of the framework data and align with their oversight and monitoring. However we note the IGC will be reliant on data provided by the provider, and so would like to see a requirement on providers to provide this in a timely manner.

Chapter 11: Impacts

Question 25: Which of the metrics do you not currently produce? (This could be for either internal reports or published data). Do you envisage any problems in producing these metrics?

N/A

Question 26: Do you agree with our assumptions regarding who will be affected by the framework?

We agree with your assumptions on who is likely to be affected.

We would also add consulting firms such as ourselves who currently support our clients in producing value for members assessments and chair's statements. We expect to support our clients in gathering their VFM framework data as well as producing their reports.

Question 27: Are you able to quantify these costs at this stage? Are there additional cost components we have not considered? Do you expect these costs to be significantly different for commercial providers and multi-employer schemes?

The costs will naturally range depending on the complexity of a scheme. We expect that the costs will be materially higher than is currently the case, and will be borne not just by the current cost bearers (governance bodies and advisory teams, the latter who will then charge governance bodies) but also by administrators and employers.

Additional costs may arise from:

- Preparing the data in the way required by regulators, such as updating / creating new templates
- Additional chasing / liaison regarding data collation where the sourcing of data is delayed, and / or providers say they cannot provide it.
- Work for administrators in identifying and providing the metrics around SLAs and the % of members who have completed certain actions, as proposed in the new framework.
- Unbundling the charges where these include investment, administration and other services, perhaps even changing contracts to enable this information to become available.
- Potential additional review of disclosures by legal advisers, particularly in the early years of new reporting.

Question 28: Overall, do you think the benefits of the framework outweigh the costs? Are you able to quantify any of the potential benefits?

We agree with most benefits.

Question 29: Are there additional benefits we have not identified?

The consultation recognised the benefit to employers. We recognise that another driver of good value for members and improved outcomes comes from employers who set contribution rates and structures. We believe this should be recognised and considered as part of VFM too, and not solely for employers to be able to assess if their provider gives good VFM.

Question 30: Do you have any comments on the potential positive and negative impacts of these proposals on any protected groups, and how any negative effects could be mitigated?

We have no further comments.

Submitted by:

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