Consultation Response

Value for Money: a framework on metrics standards and disclosures

Department for Work and Pensions, Financial Conduct Authority, the Pensions Regulator

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About this consultation

This consultation from the Department for Work and Pensions, the Pensions Regulator and the Financial Conduct Authority, seeks views on policy proposals to require trustees and managers of defined contribution (DC) relevant occupational pension schemes and the providers and Independent Governance Committees (IGCs) of workplace personal pension schemes to disclose, assess and compare the value for money their workplace pension scheme provides.

Key points and recommendations

- Value for Money is a concept at the heart of delivering good outcomes for pension savers, and we welcome the introduction of a framework to assess and compare different pension schemes.
- While the system is understandably focused on accumulation, how it interacts with pension access decisions and decumulation is also very important.
- The framework should be based around a 'north star' vision of whether someone's pension savings deliver a decent standard of living throughout their retirement. Only this can truly mean that the pensions system is fulfilling its purpose.
- Governance is crucial to delivering good outcomes and should be included as a fourth pillar.
- The three proposed pillars are not all equal in relation to achieving our 'north star' vision, and they should be weighted accordingly, with quality of services downgraded.
- The fact that past performance is not a guide to the future is a limiting factor for the framework, and this should be made clear.
- Establishing a Value for Money framework is an essential pre-requisite for a solution to the small pots issue.

About Age UK

Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe and secure at home; and feel valued and able to participate.

Introduction

Age UK agrees that the concept of delivering Value for Money (VFM) in pensions schemes is integral to assessing how savers' money is faring. However, while desirable, the concept is difficult to define, even harder to measure, and potentially extremely difficult to enforce accurate assessments. This might lead to several challenges with designing a one-size-fits-all framework, with vested interests pushing their own commercial interests to the fore. Nonetheless, we believe this is the only viable way of designing a meaningful scheme that allows comparison across different schemes.

As the pensions market is essentially dysfunctional[i], i.e. the saver is a passive recipient of a product, whereas the purchaser/decision-maker is the employer, we agree with the proposals to initially focus on trustees and Independent Governance Committees (IGCs), alongside some limited employer involvement, and with the longer term phase two aim of engaging savers more closely. The RAG rating (i.e. red, amber, green) is a sensible way to rely the results to non-professional audiences.

In spite of all the different component parts, **the crux of the matter is whether someone's pension savings deliver a decent standard of living throughout their retirement.** This should be a 'north star' by which to guide the entire pension saving system, and the Government should consider how to build this into the framework – the purpose of pensions is ultimately to help people maintain a standard of living throughout their later life.

It should also be recognised that greater support is needed to help savers make the transition to retirement. It is all very well building up a large pension pot and receiving great customer service, but if you get scammed out of all your savings, transfer your money to a cash savings account, or simply buy a high-charging drawdown product, the system will be failing. Retirement income product pathways need to be established to guide people through their later life.

The VFM criteria

We support the three component parts that the Government and regulators have broken VFM into (investment performance; costs and charges; and quality of services), although arguably 'investment performance' is the other side of the 'costs and charges' coin and they should be part of the same pillar.

However, we have two major concerns with this approach. Firstly, we believe that 'governance' should be included as a fourth pillar. This is an essential component, which does not fit easily under the other three. The quality of the governance, whether through trustees or Independence Governance Committees, makes a significant different to member outcomes. Part of a 'governance' criteria could be about how schemes help the members move into the decumulation phase, which is of crucial importance to the future of pensions.

We also agree with the Government that trustees and IGCs should not be able to self-assess – this would clearly negate any possibility of an objective framework being put in place.

Secondly, we believe that there should be a clear system of weighting for each of the criteria. As noted above, the ultimate aim of the defined contribution pension system is to allow savers to build enough money to maintain a decent standard of living throughout retirement. However ‘quality of service’, while obviously a desirable and useful metric to include, is not of equal important to ‘costs and charges’ or ‘investment performance’ in this regard – sending a well-written letter and annual statement does not help scheme members have more money when they come to retire. It may, of course, help members take better decisions, but this is a highly complex area and the evidence is patchy.

It could be used as a ‘get out of jail free’ card for schemes who are delivering poor returns or have high charges.

An eye on the future

One conceptual difficulty with the framework is that past performance is not a guide to the future’. This means it is not possible to say whether a scheme will deliver good VFM in a future year, only that it has done in the past. While the proposed solution of included modelled outcomes will go some way to resolving this, there is no complete solution (as not even investment managers can predict the future).

The only certainty within the framework will be the level of charges that are being levied on members. As a result, we believe this is the most important area, and although the detail on charges is a debate for another place, it is important that the Government’s approach to charges is consistent and fair to consumers at all times. For example, if the Government decides to relax the charge cap to allow DC schemes to invest in private finance (which is more expensive than other investments) this could have profound implications for how VFM is benchmarked and for savers’ retirement outcomes, not necessarily to the advantage of consumers.

Consultation questions

Q1: Do you agree with the proposed phased approach?
We agree with the phased approach. It is important to get the system up and running within a reasonable timescale and we recognise the constraints with attempting to make the framework run before it can walk.

Q2: Do you agree with our focus on and approach to developing backward-looking investment performance metrics?

We agree this should be included in the framework, however the statement “while past performance is not always an indicator of future performance at the level of individual funds” raises an interesting question. Although there may be a correlation between asset class and performance, there are no guarantees and schemes often change the asset allocation in their default fund, meaning the “not always an indicator” phrase is potentially misleading. This should be reflected in the final metrics for the framework.

Q5: Do you agree with proposals for the additional disclosure of returns net of investment charges only?
Yes, we believe that net investment return remains the key metric for employers and savers to assess whether they are receiving value for money, and a clear presentation of this metric is important.

Q7: Do you think we should require a forward-looking performance and risk metric, and if so, which model would you propose and why?
We believe the framework should include a forward-looking metric, which could be used as a counterweight to the (naturally) more backward-looking focused nature of VFM assessments. While we do not have a specific view on the proposed models, it should be clear that all modelling is based on certain assumptions, so making the process as transparent as possible is important. There should also be some emphasis on how to communicate the modelling results to employers and savers who may have a limited understanding here.

Q17: Do you agree with a ‘three categories’ / RAG rating approach for the result of the VFM assessment?
A traffic light-style system seems broadly appropriate. It would, however, be better at indicating poor value or failing schemes, rather than leading employers towards ‘best in class’ – it should be clear that it is not a tool designed as the sole mechanism by which employers should compare schemes when deciding where they should enrol their employees. For example, it is difficult to see how the four main master trusts would fail to achieve a ‘green’ rating – however they each have different charging structures and investment strategies which make a material difference to how much money savers will receive once they come to access their pension. Such a decision is a highly nuanced one, and dependent on the profile of an employer’s workers as well as the features a scheme may offer, and this is too detailed to be delivered by a simplistic RAG system. This should be made clear and further guidance provided.

Q30: 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?

The impact of VFM on different age cohorts is an interesting question. At different ages, people are invested in different assets, which makes a material difference, and we support the proposal for measures the are differentiated by age cohort. While we are optimistic that lifestyling can be accounted for by the framework, other issues, such as investing in different asset classes which will have different investment fees associated with them, can make a difference that is more difficult to detect.

We also believe the DWP/FCA/TPR should undertake a detailed equality impact assessment to examine the costs and benefits on different protected characteristics in more depth. As the four main master trusts are looking after the money of many lower income and disadvantaged workers, how they fare under the framework is an important question – for example how the framework treats different fee structures could make a material difference to, for example, savers from ethnic minority backgrounds. The Government and regulators should pay careful attention to such factors as it develops the framework, and work closely with the master trusts.

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[i] Office of Fair Trading (2013), Defined contribution workplace pension market study