Value for money: What will this mean for the role of trustees?

Donna Walsh assesses the strengths and weaknesses of the value for money framework

Value for money is a term most of us use at some point or another. But what exactly do we mean by it? And what does this look like when it comes to assessing our pension provider?

These questions have been in the spotlight recently, thanks to the FCA's consultation on a value for money (VfM) framework for defined contribution schemes.

Standard Life recently surveyed around 3,000 customers on their attitudes to value for money, accompanied by in-depth interviews.

This research confirms that value for money means different things at different stages of a person's life.

People tend to evaluate value for money more towards the beginning and end of their retirement savings journey, according to our research.

When asked, people in their first job said value for money meant having a pension provider that 'shares my vision'. Young people don't necessarily know how much they'll need in retirement or when they'll retire. So, they want a provider that will take them on that end-to-end journey. Trust is incredibly important.

Savers in their middle years, in the accumulation stage, tend to be less preoccupied with value for money when it comes to pensions. If they had to think about it, this group is more inclined to think about investment returns.

Meanwhile, savers accessing their pension often emphasised that they didn't know what they didn't know about pensions. For this reason, they wanted a provider that provides good information and guidance and is proactive in speaking to them about the key considerations.

So how well do these customer perceptions align with the VfM framework? And what do they indicate about the framework's likely success in delivering better member outcomes?

Are we being served?

The VfM framework has the potential to be a force for good. It should help to remove consistently poor-performing schemes from the industry, induce consolidation, reduce fees, increase average investment returns and most importantly improve outcomes for members.

It should also enable the shift away from a tendency for some employers and advisers to choose schemes based largely on cost.

But how much difference will it make to already well-performing schemes? And what does it indicate about how 'value' might be perceived and measured in future?

Undoubtedly, the framework has limitations. It might be likened to a car MOT. It will tell you which master trusts are 'road-worthy', that is, broadly credible, but not which one will be best suited to the needs of a particular set of employees. This is most evident with respect to 'service'.

Although the framework is right to emphasise the importance of service in evaluating VfM, it is relatively restrained in the metrics it includes for doing this. (In the previous consultation these metrics are described as a 'starting point' and 'not intended to be comprehensive'.)

This approach is understandable. Trying to encompass all conceivable aspects of service into the framework might leave us waiting a very long time.

That said, it risks omitting many of the things that might affect members most. For instance, the framework's focus on 'long-term outcomes' arguably underplays the importance of the member 'journey'.

Indeed, the two are often linked. Seeking to improve members' financial wellbeing in the short term, for example, is based upon the idea that this could improve their more general wellbeing in the short, medium and long term. The net benefits of doing this should not be underestimated. Particularly as the industry strives to help members to manage their finances more holistically, and to feel confident taking on the increased level of decision-making they face with respect to their pensions and retirement plans.

Member experience

Is there also a risk of the framework becoming a distraction from genuine quality? For example, providers might be asked about engagement with digital journeys and apps without considering the quality and efficacy of these digital journeys and apps.

As we all know, our perception of value for money also often changes during an experience. If an experience goes badly, suddenly the low price we paid can start to feel much less of a bargain (consider the last time you were seriously delayed at an airport). Instead, we might come to appreciate more the quality of the customer service.

At key moments for savers, the care, compassion and knowledge of a customer service representative, the ease of digital journeys and the follow-up communications are also likely to colour savers' perceptions of value for money. It does not seem unreasonable to suggest that such experiences (good or bad) could affect a member's subsequent engagement with their pension and retirement plans.

Moreover, the framework's focus on the accumulation stage – rather than the decumulation point, where many of the most critical decisions are likely to be made by savers – is a missed opportunity. With an at-retirement crisis looming in the UK, now is the time to make clear how different providers are providing value to people as they approach retirement and during retirement.

Eye of the beholder?

It is also still unclear whether the framework will fully iron out the inconsistencies in how trustees of different schemes and different employee benefit consultants (EBCs) might assess value for money.

Imagine, for example, an EBC recommending a move to a new master trust based on their value assessment, but the ceding trustees not approving the bulk transfer of members because their value assessment of the new master trust differs from that of the EBC. In such a scenario, both master trusts might easily pass the metrics as laid out by the framework, so who then decides who provides the better value?

It is easy to see how such inconsistencies could pose a barrier to consolidation.

Lessons from Australia

Of course, it will be difficult to improve value for money for members without greater consolidation, thereby enabling greater economies of scale and providing greater investment opportunities, such as those outlined in the Mansion House Compact.

Here, the Australian experience is salient, where the rate of consolidation in recent years has been eye-catching. Much of this has been down to the country's performance test, which is sometimes likened to the VfM framework in the UK.

The performance test, however, is more penal than the UK's VfM framework and arguably even narrower in scope.

Applied by the regulator, the test assesses investment outcomes against pre-determined benchmarks – with onerous consequences for failure. Undoubtedly it has removed under-performing schemes. That said, in some respects the Australian model is simpler: there is one default per provider, on which their survival depends. So the pressure is on.

In the UK, on the other hand, it appears that, under the VfM framework, the regulators are proposing that you will be allowed to run multiple defaults. If one of them doesn't work, members can be transferred to another default. It will be interesting to see how this interplays with the recent DWP consultation looking at 'megafunds'.

There's also an argument that Australia's performance test should be more complex. Currently, it tests performance against a benchmark and choosing a benchmark effectively means choosing an asset allocation structure. So, the test compares how well a scheme has delivered against that asset allocation, but it doesn't compare different asset allocation approaches.

This means that a higher performing fund could fail the performance test, because it falls below its own benchmark, while a worse-performing fund could pass the test.

There is also a lot of homogeneity among Australian schemes. The range of funds and the asset allocations within them are very similar, generally leaving savers with little meaningful choice. And could it be a consequence of the focus on investment that the administration service level agreements are met less than 50 per cent of the time?

This perhaps points to how value for money can be more effectively measured in the UK – by factoring in service and decumulation as well as more forward-looking forms of value.

In summary, value for money will continue to be front of mind for trustees. But the framework itself is unlikely to challenge or change the focus of trustees of good quality schemes.

Instead, the role of EBCs is likely to prove essential in providing advice on the relative strengths and weakness of different master trusts, which may not be proportionally captured by the framework – but which may prove to be of increasing value to members.

Written by Standard Life head of master trust, Donna Walsh