Identifying value for money in pensions

With the FCA consulting on how to ascertain the value for money of contract-based DC schemes, industry experts argue more needs to be done to improve member outcomes, finds Jon Yarker

Summary

- Generally the FCA's work to assess VFM has been encouraged by the industry, with experts wanting to see decision-makers empowered with standardised data that doesn't exist.
- The proposed traffic light system – where green, amber or red ratings are used – has been heavily criticised.
- Not only will 'value' be difficult to define in this consultation, but comparing different schemes will likely prove to be very challenging.
- Value is an important concept for members, but the regulator can do more to build on this and to improve decisions made around pensions.

In August, the Financial Conduct Authority (FCA) launched a consultation into proposed rules and guidance around value for money (VFM) for contract-based pension schemes. In a bid to drive greater value for members, the regulator is proposing the introduction of a traffic light system in schemes' public disclosures. The ultimate aim of this work will be to design and implement a joint framework with The Pensions Regulator (TPR) and Department for Work and Pensions for workplace schemes to be used by pension providers and those making decisions on behalf of savers.

With feedback due by mid-October, the consultation has been broadly welcomed by those in the industry. One fan is WTW senior DC consultant, Gemma Burrows, who says there is a need to look closer at value to improve member outcomes – citing the value-based approach already used by TPR to push poorly run own trust schemes into consolidation.

"We welcome the greater focus on this, although there are inherent challenges in determining value at scheme level and it is likely to be different for each member, for example when the member joined, the investment they are in, their retirement choices and the different features and models," says Burrows. "Inconsistent VFMs could have serious commercial and market implications and cause problems for member understanding."

Concerns around consistency aside, a VFM framework could help inform decisions around scheme choice. This would support employers according to LCP partner, Steve Webb, who says there is currently a lack of comparative measures that can be used.

"If it was much easier to compare different providers on metrics other than price, employers and their advisers might be more likely to shop around and this could provide competitive pressure on providers to improve their overall offering," adds Webb.

"From the perspective of the consumer, choosing where to consolidate their scatted pension pots can be difficult; simple VFM ratings could be helpful to them, perhaps ultimately being displayed on pensions dashboards alongside the list of their pensions."

A red light to colour grading

The pension industry may be welcoming greater scrutiny of VFM, but the proposed traffic light system has not gone down well. This would see schemes given a red, amber or green rating and firms bound to make improvements if arrangements are assessed as red or amber. The Lang Cat director of public affairs, Tom McPhail, isn't a fan and says this approach is "reductive" and "crude".

"It's important the VFM metrics are captured and presented in a format that can be accessed and interrogated by anyone with an interest in this market, including journalists, employers and members," states McPhail. "Preferably, the regulators should make the data accessible in a standardised format allowing external third parties to use it for comparison website type purposes."

Webb is also sceptical and is concerned about the repercussions of such a system. Like the way actual traffic lights can dictate traffic flow in a city, Webb questions how these ratings could impact investment decisions within schemes.

"Unless you are rated 'green', you are forced to close to new business and also to report to your existing customers that your scheme is not regarded as being currently good value for money," says Webb, highlighting no one will want to do this. "Which could easily lead to 'herding' of investment strategies; being in the middle of the pack is a safe place to be, whereas taking on investment risk in the interests of long-term growth could expose you to a commercially catastrophic risk if things do not turn out well."

Unlike others, Hymans Robertson head of DC governance consulting, Claire Kapitan, likes the concept of this traffic light system and applauds its simplicity and clarity. However, with a focus naturally gravitating towards schemes with amber or red ratings, Kapitan warns against complacency being created by green ratings.

"It's important to note that a green VFM rating should not imply that VFM cannot be improved further," she adds. "Value changes over time, particularly in areas like technology, communications and investment strategy, so it will be important to look at value on a regular basis."

The challenge facing the regulator

The FCA's work has been welcomed by the industry, but experts appreciate that this is a difficult task. To an extent, this is largely a reflection of the scale of the industry and the lack of standardisation of data that currently exists. Burrows highlights that there will be a challenge for the regulator to classify what value exactly looks like, given investment performance is difficult to compare across different strategies and retirement targets.

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In particular, she warns there could be an issue for workplace pension schemes to use Independent Governance Committee (IGC) conclusions in these assessments. If these IGCs choose their own comparators, results could be skewed which highlights the importance of access and reporting to verify VFM rankings.

"The availability of data and ease of reporting, particularly for older legacy arrangements will need to be considered," says Burrows, who warns that the process of gathering such data can be lengthy and problematic.

"There will need to be some consideration on what happens if a scheme is identified as not delivering value. Receiving vehicles for transfers from very small schemes will be hard to find and transacting could be uneconomic relative to the assets in the scheme."

Webb agrees that difference in size can also have significant impacts to determination around value with bigger schemes scoring differently on various VFM measures simply due to their size.

"If the ultimate outcome was that such schemes wind up and members all end up in a master trust, there is a risk that employer engagement and commitment to pension provision could be undermined," he says. The scope of this data will also need to be considered. The FCA is proposing looking at performance over one, three and five years – something that Webb says is at odds with the long-term nature of pensions and the decisions around these.

"There is a risk that investments which would be good for members over the long run but potentially take time to deliver or have short-term volatility could show up badly in league tables," he adds.

Going further

The FCA's VFM work is aiming to improve member outcomes, but value is only one part of this issue. Identifying VFM is important, but what happens next will require focus as well according to Burrows.

"Crucially, there needs to be some attention given to moving members when poor value is identified," she says. "It needs to be easier to move members of GPPs without consent."

McPhail also wants to see this work built on. Instead of simply identifying low value schemes, and potentially penalising these, the public affair's director wants an approach that makes it easier for decision-making.

"The answer to the question of 'is provider A better than provider B?' is always 'it depends' – this is no longer good enough," says McPhail. "We should do what Australia has done and require all providers competing in the auto enrolment marketplace to have just a single set of charges, which applies across their whole book of business."

Written by Jon Yarker, a freelance journalist