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The VFM framework – next steps

On 11 July 2023, following the Chancellor of the Exchequer's Mansion House speech, the DWP, The Pensions Regulator and the Financial Conduct Authority published a joint response to the consultation (Value for Money: A framework on metrics, standards, and disclosures) published in January. This document is part of a number of documents published by the DWP "all designed to drive better outcomes for pension savers".

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Background

Our FYI dated 9 February 2023 (Introducing a new value for money (VFM) framework for all DC pensions) sets out the proposals for a consistent regulatory framework that were launched at the beginning of 2023. The plan is to create a framework where the same requirements apply across the whole workplace DC market.

The framework will introduce "a clear set of comparable metrics and standards for schemes to assess value for money". There will be three components covering: investment performance, costs and charges and quality of services. The intention is to support and accelerate the consolidation of underperforming and poorly run schemes with better run schemes, with increased powers for The Pensions Regulator to require the underperforming schemes to wind up and consolidate. For those schemes that are already at scale, the framework proposes to provide greater transparency and standardisation of reporting so that employers can better compare value and performance.

The VFM framework needs new primary legislation, DWP regulations and FCA rules as appropriate. It will be implemented in phases although no timescale has yet been confirmed.

Interaction with the wider policy framework

Consolidation
The DWP has proposed an assessment approach that will give schemes a clear timeframe for demonstrable improvement of their value for money. Both The Pensions Regulator and the FCA will be given powers to intervene if there is continued underperformance.

Improving investment diversification
In the first phase of implementation, it will be mandatory for all DC schemes to disclose the percentage allocations in their default investment arrangements to the eight key assets classes that currently feature in policy regulations. Disclosure of more granular sub-asset classes, such as: UK vs non-UK investments; key sectors such as technology, life sciences, climate and sustainable energy; and exposure to venture capital, will be encouraged via guidance.

The purpose of this is to inform comparisons and provide clear examples of the importance of a diverse mix of investments (i.e. to protect savers and bring about the best investment performance), and to maintain focus on investment sectors which are aligned with wider policy objectives.

However, this would not form part of the assessment process that determines the VFM score.

Value for members assessment
All workplace DC schemes will be required to undertake the VFM assessment. Further clarification about the transition timelines for replacing the existing value for members assessment that applies to trust-based schemes with under £100m in assets under management will be provided at a later stage. In the meantime, it will continue to apply with underperforming schemes required to take immediate action.

Deferred small pots
A response to the call for evidence published in January has been published alongside a consultation on a new policy for stopping the number of unprofitable, often lost, deferred small pots. This includes a number of default consolidator schemes.

Decumulation
The DWP has published a consultation about a set of communication touchpoints throughout the pension savings journey. All occupational pension schemes would have to offer or facilitate access to decumulation products and services.

Collected defined contribution (CDC) schemes
As the VFM framework and the CDC regime are both aimed at improving saver outcomes, it is expected that CDC schemes will be included in the VFM framework during the latter phases of implementation.

Pensions dashboards
Eventually, it is expected that dashboards will show a pension scheme’s VFM assessment outcome.

The FCA’s consumer duty
Disclosure of a standardised set of VFM framework metrics will enable independent governance committees (IGCs) to consider price and value aspects of the consumer duty rules.

The phased approach to implementing the VFM framework

The primary focus will be on workplace default arrangements as this is where most DC pension savers can be protected from remaining in underperforming schemes for long periods.

Whilst recognising that savers in older schemes may be at greatest risk of poor VFM, there are challenges for legacy workplace schemes. These will be addressed with the industry.

Primary legislation is needed for many of the VFM framework proposals including DWP regulations and FCA rules that will also pick up details on phasing.

Investment performance metrics

Instead of a net of all costs and charges metric, the intention is to proceed with a gross investment performance metric with costs and charges disclosed separately. The aim is to reduce the amount of data points required from multi-employer schemes (i.e. master trusts) but still provide meaningful backward-looking data for assessment purposes.

Reporting periods will be of 1, 3 and 5 years, with 10 and 15 if available and these will be based on years to retirement from the scheme's default retirement date.

Alongside gross investment performance, and over the same periods, the intention is to proceed with maximum drawdown and/or annualised standard deviation as risk-adjusted metrics.

For schemes that have changed investment strategies over time, chain-linking data will be required for the reporting periods of 1, 3 and 5 years in order to show the actual investment experience of members rather than the performance of the current strategy. It is proposed that schemes can disclose non-chain-linked data alongside the chain-linked.

Schemes will be expected to disclose return net of investment charges figures over 3, 5, 10 and 15 years, whether that information is readily available.

Forward-looking metrics will be included, but it was clear that this is a complex area, and the intention is to undertake further work with the Government Actuary's Department and industry first.

Costs and charges

The intention is to proceed with the proposals to disclose charges related to services to aid comparison. However, it is acknowledged that there are difficulties with this. Further work will be carried out to see if combination charging structures used in automatic enrolment schemes and legacy schemes can be converted into an annual percentage in a proportionate way.

Multi-employer schemes

The intention of the proposals was to provide greater transparency where charging levels varied by employers by breaking these down into cohorts which would be prescribed. The intention is, however, to explore whether this is best achieved by means of a range or by a defined categorisation.

Quality of services

The proposals relating to member communications included quantitative service metrics looking at the percentage of members who update/confirm their selected retirement date, and how they wish to take benefits, and/or update their expression of wishes plus the outcome of member satisfaction surveys.

The intention is to work with industry to develop a standardised member satisfaction survey and add a metric around member complaint data. However, the metrics for updates/confirmation of members' selected retirement date and how they wish to take benefits were determined not to be accurate indicators of quality.

The proposals relating to scheme administration included metrics around promptness and accuracy of core financial transactions and quality of record keeping.

Again, the intention is to work with industry to achieve consistency and clarification will be provided to schemes about how to measure transaction times. More work is needed in this area to make the data disclosed meaningful. Benchmarks or standards will not be set initially.

Disclosure templates and publication timings

The intention is to proceed with a decentralised approach for the publication of the framework data. A prescribed, machine-readable disclosure template would be published at the same time in Q1 which covers the same reporting period. (Annex 2 of the response contains an illustrative example.) Further work is to be done on whether URLs could be collected across both regulators to develop a single directory of published framework data.

The intention is to have a reporting end date of 31 December (i.e. schemes will publish the framework data by the end of Q1 the data collated from up to 31 December of the previous year). Schemes would use this data to conduct and publish VFM assessments by the end of October. The regulators will be able to consider taking action or impose penalties for late or poor-quality data and assessments.

Assessing value for money

Regulator-defined benchmarks and market comparisons

As the VFM framework is introduced the existing value for members assessment will be phased out. However, to start with, schemes with less than £100m of assets will continue to assess the value for money provided by their scheme through a comparative exercise with schemes of sufficient scale to deliver good outcomes. The expectation is for industry-lead league tables to emerge as the framework data becomes available. Regulator-defined benchmarks will be introduced.

Step-by-step process

The intention is for guidance to be given to ensure a standardised step-by-step approach can be used, with some changes from the proposals due to the changes in the data metrics.

RAG rating approach

The proposed RAG rating approach (unable to achieve (red), able to achieve with identified actions (amber) or achieving (green)) will apply as it allows for a simplified identification of a scheme's VFM. The idea is that regulatory scrutiny can be used to highlight best practice and challenge unsuitable decision-making.

Contract-based schemes – transfers without consent

The intention is to explore legislative changes to enable providers to transfer pension savers without consent, internally or to another provider. IGCs would determine whether a proposed transfer is in the best interests of the pension savers. This a complementary piece of work with the DWP to providing solutions to the issue of small pots.

Communicating the VFM assessment

A mandatory communication will be issued to employers where a scheme is not providing value for money. This will be given within a reasonable time frame of the assessment and will include actions the scheme intends to take to either improve or transfer/wind-up.

Where the assessment is red “with no credible prospect of achieving VFM it is expected that consolidation would begin, or the scheme would explain why it cannot or why it would not be in members’ best financial interest to do so. The scheme would be subject to regulatory scrutiny and potential action.

Where the assessment is amber, an action plan would be put in place during the first year of the assessment. If it is still amber for the next year and cannot demonstrate improvements in line with the action plan, consolidation may be expected or imposed.

The chair’s statement

The response confirms that a separate document for members would not be beneficial or aid member engagement and could create complexity and confusion.

Also confirmed is an intention to phase out the chair’s statement once the VFM framework is phased in.

FCA specific issues

The FCA is to consider further the issues for individual SIPPs. An annual IGC chair’s report will continue to be required but the FCA proposes to require a summary of the VFM assessment for pension savers to be included as part of the existing annual communication by IGCs to scheme savers. The intention is for the provider to be the publisher of the VFM framework data (rather than the IGC or IGC chair).

Comment

As would be expected after a lengthy consultation from three bodies and with responses from 80 interested parties, the response is also lengthy. Also expected is the outcome – the DWP, The Pensions Regulator and Financial Conduct Authority are “committed to the pursuit of good saver outcomes”. They believe that “a disclosure framework for the holistic assessment of value for money is key to making this a reality”.

The inevitable outcome is that any trustee or employer involved in occupational DC schemes face more work ahead to either demonstrate they are meeting the new requirements or consolidating within a master trust. There is no doubt that these latest reforms will accelerate consolidation and we suggest that trustees and sponsoring employers waste no time in reviewing their options together to agree their preferred future direction on their own terms.

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