PENSIONS AND LIFETIME SAVINGS ASSOCIATION

FCA/TPR DISCUSSION PAPER: DRIVING VALUE FOR MONEY IN DEFINED CONTRIBUTION PENSIONS

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SUMMARY

The PLSA welcomes this discussion paper (DP). We fully support ensuring savers benefit from good value for money (VFM) in their pensions, and the intent to build a framework through which schemes can demonstrate that to savers. We also support the joint regulatory approach; good value should not be incumbent on the type of pension scheme a saver finds themself in. However, we are concerned that aiming for complete consistency between different schemes risks creating a set of standards which are not wholly appropriate for any scheme individually, and that moving to a new standard could place additional regulatory burdens on schemes. Our response covers the following broad points:

- Purpose – a clear view of the intended outcome would help inform the VFM assessment process. Enabling like-for-like comparisons across a wide-ranging market will be challenging, so establishing specific areas the Regulators wish to increase value would be helpful, and help ensure solutions are practical for schemes and providers.
- Audience – the parties intended to be making the comparisons will dictate suitable levels of data disclosures, so we would welcome further discussions with Regulators on the expectations, and any likely mandatory requirements, on IGCs and trustees in particular.
- Existing requirements – linked to the audience is the question of existing requirements of schemes and alignment with these. It is vital significant additional regulatory burdens are not placed on already stretched schemes. The costs of which would be passed on to members.
- Investment performance – we welcome the importance attributed to investment growth in the DP, especially in light of DWP's drive for greater allocations to illiquid assets. We also support the requirement for net performance disclosure and shift away from a focus on costs.

PLSA RESPONSE

Below, we lay out our response to the DP across various areas, including the overall purpose, approach and outcomes the Regulators are seeking, the wider regulatory and legislative context, as well as some feedback on the more detailed proposals. To inform our submission, we have canvassed a range of our members including schemes, trustees, and providers, through a survey[1], roundtable, bilateral meetings, as well as discussion at our policy committees.

<u>Purpose & approach</u>

As above, it is right that all pension schemes, regardless of structure, should provide savers with good value. The DP raises the question as to whether the Regulators believe that the market currently does not offer good value, or instead that there are pockets of poor value that should be resolved. Our understanding is that the implicit intention is to improve VFM market-wide, rather than tackling a few 'bad actors'. We believe other targeted actions alongside this are likely to be

[1] PLSA member survey conducted between 26 October and 5 November 2021 with 18 members responding.

more effective. A phased rollout has been suggested which would begin with the largest – likely automatic enrolment – schemes. We would find this incongruous and it may present policy design challenges as, by most metrics, this segment of the market is likely to offer the 'best' value. This is certainly the view held by government, evidenced by the wider DC consolidation agenda. Auto-enrolment workplace schemes are already charge capped (preventing excessive fee erosion) and efforts to increase illiquid asset exposure are expected to, over time, increase investment growth offered. These are very unlikely to appear 'bad value' when compared with the rest of the market. Moreover, with this knowledge, there is a danger that such schemes will opt to 'stay in the pack' rather than innovate to further improve value, which would run contrary to the Regulators' aims. Meanwhile, the rest of the market, and any genuinely poor value schemes, are likely to be consolidated in the coming years, in any case, due to natural evolution, market forces and other legislative and regulatory interventions. Therefore, we would like the approach to account for current dynamics in the market and prioritise value interventions accordingly.

That said, the DP is a good starting point, and identifies the three vital components of VFM to provide a firm basis for comparison. We welcome the alignment of these components with other value assessments (including DWP's value for members and FCA's recent requirements in PS21/12), having previously advocated consistency across accumulation and decumulation to aid greater understanding and reduce duplication. The natural next step will be to specify how the three elements interact with each other, whether they are to be seen in isolation, or if they will be assessed together. Either way, it will be crucial to reflect the relative importance of each element, through weighting. For instance, how might a good administration and comms 'score' attenuate poor investment growth for a scheme, especially if the former is overseen by a neutral body and the latter by the Regulator? Schemes will need to know whether they have the discretion to decide on their own weightings according to their own objectives, or whether the Regulators will prescribe these.

We have some concerns about the envisaged outcome, and how the Regulators see the industry getting there. While a framework to compare all types of pension is a laudable aim, it is not clear that truly reliable comparisons can be made across such a varied market, with schemes that operate in completely different ways. In the contract-based sector, competition between providers for the end-to-end business of running a scheme is made possible by IGC value assessments, with a switch of provider ultimately up to the employer (or member). In the trust-based world, trustees are responsible for assessing the value of their overall pension offering (in some cases including multiple schemes with different structures and objectives), and each individual service provider, to cover a range of needs, such as administration and fund management, and have the discretion to improve VFM on behalf of their members. Employers also retain an interest in the running of the scheme in the trust sector, so a different approach may be needed.

Moreover, it is unlikely a like-for-like comparison would emerge; by way of a simplified example, developing a common benchmark for an administrator catering for a single employer trust and a full-suite pension provider in the contract sector is likely to be highly challenging. As such, more thought must be given to the difference between comparing value metrics at scheme level and 'service' level (for example, administrator, asset manager, legal support), as well as individual member or schemes' objectives. Such differences in scheme structures and demographics are the basis for the DC Code's assertion (paragraph 116) [2] that:

"there is no uniform approach to assessing value for members that is suitable for all schemes. We expect trustee boards to make efforts to understand the characteristics of their members and, where possible, their preferences and financial needs, and to take this into consideration when exercising their judgement about what represents value for members."

Feedback from our members indicates agreement with this, and that existing reporting and assessment practices reflect the range of schemes in the market, so in this sense, the DP represents a significant change in direction from the Regulators on VFM.

It would be more instructive to include some assessment of a scheme's goals in view of its demographics (age, affluence, level of pensions engagement, contribution levels), and then to measure its progress against this, rather than against a benchmark created from a mix of schemes with different objectives and strategies. This would also address what we see as other incompatible value comparisons in the proposed approach, such as assessing non-workplace schemes against the wholesale purchasing power available to large occupational schemes for instance. It is unrealistic for the former to achieve the institutional scale of the latter, and the consequential differential pricing.

Furthermore, an undue focus on industry-wide benchmarks may – similarly to the point made above - engender industry homogeneity, with providers preferring to stay in the pack, rather than strive to improve and outperform. In investment terms this may result in more allocations to low-cost passive equities as a 'safe' option, which would run counter to the government's initiatives to boost private markets investment and high growth areas of the economy. Evidence from other jurisdictions, such as Australia, suggests this is a real risk, and one which any intervention should be designed to reduce rather than exaggerate. Similarly, proxies for 'value' are often reduced over time to an interpretation that *lower cost* is the key aim. Interventions designed to prompt value comparison must therefore be sensitive to the potential that they reduce quality (as decision makers seek low-cost solutions where they are incentivised directly or indirectly to do so) rather than increase it (as decision makers are not sufficiently incentivised to select better value solutions).

Audience

Linked to the approach is uncertainty over the audience for the proposed disclosures. The DP covers much useful ground in seeking to establish metrics for comparison, but appears undecided over who will assess these, by mentioning all of the following: governance bodies, employers and savers. Establishing who will be expected to make scheme comparisons (and any associated compulsion) will be a natural prerequisite to deciding on the manner and level of detail required in

[2] https://www.thepensionsregulator.gov.uk/en/document-library/codes-of-practice/code-13-governance-and-administration-of-occupational-trust-based-schemes-providing-money-purchase/#576da7373de042e3a115a0f09c800fd9

the disclosures. As per the FCA's own guidance on smarter consumer communications[3], and the requirement for communications to be *clear, fair and not misleading*, achieving an appropriate level of information for a given audience will be crucial, and this challenge must not be underestimated, as within each audience, levels of understanding will vary, even among non-retail audiences. Moreover, the audience must be carefully mapped where the actor or decision maker may well be different, or where there is a duty to act on behalf of the member. It is also - as yet - unclear what information is designed for the Regulators' consumption, and what would be done with this information.

Our member survey reflected this uncertainty over the intended audience, though trustees emerged as a preference (80%). Our view, as per our response to Q12, is that only a small proportion of the most engaged members would use these disclosures, and in the scenario that they did decide to change their pension arrangement as a result of them, very careful consideration would also need to be paid to the value of the employer link and associated benefits which may not be available elsewhere. So, for the purposes of this submission we will assume it is those overseeing schemes, i.e. IGCs and trustees, who will be expected to compare schemes or services.

Existing requirements

One clear priority among our members is that new VFM requirements do not overlap with or create inconsistencies alongside existing regulation and legislation, notably the DC Chair's statement, to avoid creating unnecessary additional burdens on scheme resources which are already stretched by the accumulating requirements on trustees (including new sustainability and TCFD reports, and considerations of illiquid assets). As above, we welcome suggestions of alignment with existing FCA regulation, as well as with DWP's statutory guidance, such as on time periods for investment reporting.

We are less clear how these new rules will apply in conjunction with existing VFM reporting schemes are subject to, including the DWP's value for members assessments for schemes with under £100m in assets, as well as the mandatory value reporting already in place within Chair's Statements and for IGCs. Many PLSA members report to us they are already assessing VFM and regularly tendering for improved service. However, more than half of those surveyed stated that resource would be a barrier for schemes making these additional disclosures, and we are concerned that any resulting costs incurred would have to be passed on to savers. Therefore, we urge the Regulators to consult government on all parallel rules, and rather than duplicating any requirements within the DC Code, seek to improve on what is already in place. Given DWP's acknowledged shortcomings with Chair's Statements, there may be an opportunity to revisit this and consolidate at least the VFM element into one disclosure.

Furthermore, we are concerned that some elements of these proposed value assessments, especially when placed alongside the mandatory reporting on illiquid allocations, may pose undue pressure on some schemes to consolidate, to achieve better 'value' for their members. While

[3] fs16-10.pdf (fca.org.uk)

consolidation is clearly a priority for government, as per our previous submissions[4], it is not necessarily a suitable route for all small schemes, especially due to high wind-up and transfer costs, which in many cases are met from members' pots. Members of some small single trusts may also benefit from their employer covering service costs, covering higher contributions, or other benefits, which could far outweigh any perceived poor value due to their smaller scale. Indeed contributions, and scheme efforts to enable members to understand the value of them, are arguably a fourth VFM component which this DP ignores. We acknowledge contributions may be less the domain of the Regulators than the other components, but when savers are picturing their retirement, and planning the finances they need for it, for instance with tools such as the PLSA's Retirement Living Standards[5], increased contributions outweigh all other factors in the context of good outcomes. Therefore, contributions must be considered, especially if their omittance may lead to savers making poor choices or inappropriate scheme consolidation and loss of benefits.

Investment performance & costs

In terms of the VFM components and the detail of disclosures, the equal footing investment performance is given, being placed alongside costs and charges is a positive step. While it is crucial that savers' pots are not eroded over time by excessive charges, these charges can only be meaningfully assessed in full view of the growth generated. Therefore, at a time when multiple government initiatives are encouraging schemes to invest in less liquid, higher growth assets, it is right that schemes are not pushed down the low-cost/low-growth route through an unbalanced focus on charges.

That said, the DP is unclear on the extent to which assessment of performance and cost interact. While the clear intention is for disclosure of *net* performance, aligning with existing DWP requirements (and something 94% of our survey respondents support), costs and charges disclosure is also discussed at length in its own right. Consideration will need to be given to which costs are factored into net performance and which are assessed separately, in order to present a true view of what savers are paying, and not exaggerate the impact of costs relative to performance.

The outcome of this work must also encourage comparison and behaviour which is consistent with the FCA's own guidance on investments. The proposals are for backward looking investment performance, however given performance changes over time, simply moving from a historically poor performing fund to a historically better performing one would constitute an investment strategy at odds with the FCA's own assertion that '*past performance is not a reliable indicator of future results*'. While we understand the difficulties in requiring forecast returns and making investment decisions based on this, a performance benchmark based on a combination may be more suitable.

[4] FINAL - RESPONSE - DWP Improving outcomes for members of defined contribution pension schemes v6.1 (1) (plsa.co.uk)

[5] https://www.retirementlivingstandards.org.uk/

Conclusion

Overall, we support the intention to ensure pension savers can count on receiving good value. The specific purpose and approach need to be clear from the outset in order that useful and proportionate requirements are instituted for providers and schemes. We would also hope that these account for the dynamic of an evolving (and already consolidating) market. This means clarity on whether the intended end point is better retirement outcomes, or simply a better process to improve VFM and governance in certain parts of the value chain.

Our view is that targeting interventions at specific areas of the market, i.e. a small number of poorly performing schemes (some have suggested with a focus on legacy products), by setting minimum standards for each of the components outlined, and simply supervising and removing the worst performers from the bottom end of the market, may be most productive initially. Market-wide value could be evaluated later on, when the outliers have been removed. Either way, it may be that for effective comparisons, the market needs to be segmented into categories of similar schemes from a governance, membership and structural perspective. As the Regulators progress with their work on VFM we would be glad to assist in any way we can to help develop a workable framework that supports all UK pension savers.

CONSULTATION QUESTIONS

Q1. Do you agree that consistent disclosure of performance is necessary to enable better decision making?

We would agree that, in principle, access to consistent data - where possible - is necessary to measure and compare performance. However, we have reservations about how standardisation would work in practice, and how we could ensure that meaningful data is obtainable, that it is scrutinised by the right audience, and that it ultimately ensures that pension savers enjoy optimum VFM. As set out above, we believe that before performance can be disclosed in a meaningful way, a clearly defined audience and outcome need to be set out, and consideration given to the kind of data that said audience can – and will – scrutinise. We note that the recent review of the Chair's Statement requirements highlighted the failure of having one document aimed at multiple audiences[6], and we would be cautious about assuming disclosure and comparison alone will drive the behaviours we are seeking to influence.

We would also note that the disclosure burden on trustees is now substantial – with annual reporting now extending, but not limited to, the Chair's Statement, Statements of Investment Principles, an Implementation Statement, and with TCFD reports, Sustainable Disclosure Requirements, and Net Zero Transition plans in the pipeline. The Chair's Statement already includes a requirement for schemes with under £100m AUM to report on VFM. Evidence from our members suggests the majority of these publications are rarely downloaded, and engagement with them is very low. While we recognise the role of disclosure in promoting good behaviours, new disclosures must serve a clear purpose, and not place undue burdens on schemes, otherwise the cost of compliance may exacerbate areas of poor value the Regulators are seeking to eliminate.

Finally, clarity on the interaction between the performance and costs benchmarks will be vital for a meaningful and accurate assessment of VFM. The requirement to benchmark both costs & charges and ***net*** performance risks further driving down cost, at the risk of service and/or the likelihood of trustees feeling that they can make long term investments (as recommended by the HMT/BOE/FCA Productive Finance Working Group[7] [PFWG]).

Q2. Do you agree that comparisons should be of net rather than gross investment performance?

The majority of our members agree that any requirements to publish this information should be presented in relation to net performance, as this gives the truest picture of how someone's savings are evolving over time.

[6] Post Implementation Review of the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (legislation.gov.uk)
[7] Productive Finance Working Group | Bank of England

We note the publication of the PFWG's report, A Roadmap for Increasing Productive Finance Investment[8] states "*DC pension schemes are primarily focused on cost, which the larger schemes currently compete for business on… As such, there is a need to shift the focus from cost to long-term value and enhanced outcomes for DC scheme members*".

A competitive market should be focused on long term value, and so any metric should reflect net performance. Neither investment growth nor costs and charges can alone give an accurate indication of value; only both combined can paint the full picture.

Q3. Do you have any suggestions on how to make disclosure of net investment returns effective given that there may be varying charges for the same funds within multi-employer schemes? For example displaying a range, or requiring disclosure of each different level of net investment performance.

This is a challenge, as presenting as a scheme wide average is likely, in many circumstances, to result in a figure that is not necessarily accurate to each employer. However, we are concerned about the viability of schemes producing sets of figures for every employer in every individual fund, the sheer volume of data this would create, and therefore the likelihood that it would be used to drive meaningful engagement and influence the type of behaviours the Regulators are seeking.

Assuming the target audience is trustees and IGCs – given the significant reporting requirements schemes already face across the board – any new requirement involving the disclosure of significant amounts of data, could result in it becoming 'lost'.

Though imperfect, we believe that the most effective tool would be a scheme wide metric that would provide the audience with a snapshot of how well the scheme 'performs' in relation to VFM. It should also be borne in mind that the purpose of this exercise is not to provide a tailored evaluation to every particularity of every scheme, but an overall view of value.

Q4. Would it be helpful to mirror the DWP's approach in terms of the reporting periods?

There is little consensus over whether VFM metrics should be in line with DWP's statutory guidance for schemes. Overall, it may make sense to align with DWP to avoid overlapping but slightly different disclosure requirements. This is especially the case as it is smaller and medium schemes already reporting according to DWP's value for members assessments, and these same schemes which are most likely to struggle to comply with requirements from a resource perspective.

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[8] [1] https://www.bankofengland.co.uk/-/media/boe/files/report/2021/roadmap-for-increasing-productive-finance-investment.pdf?la=en&hash=F92ADDFB1B815895AAFCC21CE6A29C5B0A74D6B7

Given this VFM assessment process is currently in its infancy, there should be time to evaluate how successful and practical the requirements are and refine the final recommendations along the way.

Q5. Would publishing a set of metrics based on age cohorts bring investment performance reporting closer to the saver's investment performance experience of a pension scheme/product? If not, is there a better alternative we have not considered?

and

Q6. When considering which age cohorts to consider, is the example we have provided appropriate? Alternatively, would it be more effective to mirror the DWP's approach?

While some schemes will already use this kind of breakdown for their own internal review, especially where members' investments are on a glidepath, many will not be able to easily access scheme investment performance data broken down by age cohort.

The primary aim of the VFM metrics is not to offer a personalised assessment of the scheme, so it is not necessary to provide a set of metrics based on age cohorts. Additionally, cohort statistics may not necessarily be more accurate than providing an average in showing whether a scheme is offering VFM. Schemes also have vastly different objectives and investment strategies based on a variety of member demographics, e.g. high/low earners, contribution rates, so the relevance of a particular age cohort across multiple schemes could be low.

In addition, the audience for these VFM metrics must be taken into account. If targeted at trustees/IGCs a single investment performance for the fund as a whole may be sufficient, especially if it is also to be risk-adjusted.

However, if age cohort data is mandated, reporting data based on proximity to retirement age may be more useful than a specific age, as in DWP's Statutory Guidance. That said, it would be clearer to quote metrics based on specific periods to retirement (e.g. five years, 20 years) rather than the example in the DP which suggests ranges (0-5, 5-20 years etc.), because investments will differ so greatly within a 15 year range, often due to de-risking, as investments move from a pure growth phase to a consolidation phase.

However, we also feel that it is appropriate to have consistency where possible with DWP's statutory guidance which specifies disclosing data for specific ages of member. It may in fact be possible to align the approach we suggest above with DWP's set ages (25, 45, 55), if the times to retirement disclosed were a set period from State Pension Age for instance.

Q7. What disclosures, if any, should be made for self-select options?

Disclosures should not be made for self-select options. The majority of savers are in default strategies. According to the PPI DC Futures Book 2021[9], 90% of master trust/multi-employer scheme members were in the default strategy in 2021. Although lower, the proportion of savers in

[9] https://www.pensionspolicyinstitute.org.uk/media/3916/20210923-the-dc-future-book-2021-final.pdf

the default is still high amongst contract schemes, where 80% of members in stakeholder schemes and 74% of members in GPP schemes were in the default in 2021.

As per our executive summary, our assumption is that these metrics will be for the use of those overseeing schemes, rather than members. Therefore, the focus should be on defaults where the majority of members are, as it is only the most engaged savers who might utilise this data. The minority of individuals who are in self-selects funds will have made an active choice based on their own perspective of value and priorities, therefore, their assessment of VFM may differ from the metrics proposed in the DP.

Q8. Do you think reporting based on age cohorts would be enhanced through the use of risk-adjusted returns as an element of a scheme's VFM assessment or would risk-adjustment then be unnecessary?

Q9. If risk-adjustment is used, what risk-adjustment metric(s) would you suggest? For example, the Sharpe ratio as i) a standalone factor, or ii) in combination with other risk metrics?

Q10. Is there any reason why it would be impractical to report on risk-adjusted performance metrics in addition to providing a metric based on actual performance returns?

We see the merits in risk adjusted performance disclosures, as they do give a more accurate idea of how a scheme generates its returns and whether its strategy is suitable for its members. So to this extent, risk adjusted returns would help avoid a system that incentivises riskier behaviour. In terms of which ratio would be most suitable, our understanding is that the Information and Sharpe ratios are the most widely understood and used metrics in the sector.

The question of audience is again relevant here, as the use of risk adjusted ratios would inevitably create more data and make the comparison process more complex, especially if combined with age cohort segmentation. Therefore, while this level of information may be useful for experienced professional trustee boards, this won't be universal, so a standard industry-wide framework may be difficult to achieve using these ratios. Based on our assumption that the audience for these disclosures is trustees and IGCs, it would seem reasonable to assume some ability to process the data, providing allowances were made for different levels of expertise within trustee Boards. As such, we would recommend limiting the required risk adjusted data. This would also help minimise the additional reporting burden placed on providers - discussions with our membership suggest that few feel they have the means to currently report on such a metric.

We would also note that risk adjusted ratios would not act as a reliable proxy for comparison of schemes' individual investment strategies, which, as discussed elsewhere, vary enormously according to the specific needs of their membership. It will be important that the fact of returns being risk adjusted does not create the false impression that all schemes are directly comparable, so we suggest it may be more suitable for risk to be assessed in an evaluation of scheme performance against its own objectives. This would also avoid excessive complexity (and cost for members) which may be an inevitable result of comparisons between different types of scheme.

Q11. What are your views on presenting returns as an annual geometric average to provide consistency with the DWP's requirement?

We agree that an annual geometric average would ensure any new requirements are consistent with existing rules. Compounding of returns has a considerable effect on long term savings, so accounting for this through an annual geometric average would provide for more accurate reporting.

Q12. We would welcome views on how you see this developing. Would it be helpful/possible to establish a benchmark, or would you prefer to compare cohorts against a market average or against a few selected similar schemes? If so, how would that selection be made?

We recognise that benchmarking can play an important role in helping understand the market. It's already the case that some schemes make use of commercial or other benchmarks, often provided by consultants and advisers, and this is beneficial for scheme members. We are apprehensive though about any drive to form regulation in this area – there is a lack consensus on how VFM can be accurately 'captured', and the complex nature of the UK's pension sector would make comparisons challenging.

In general, our members would like to see more development of good value commercial benchmarks that enable schemes to make comparisons where they can be helpful to schemes' and providers' assessments of their own proposition. We note the suggestion in the paper that deriving benchmarks from a public or non-profit offering, such as NEST, might demonstrate opportunity cost. Although NEST benefits from a government subsidy, and its scale also means that it is less likely to be an appropriate comparison of the true minimum cost of running a scheme. We would not, therefore, see this as an appropriate common benchmarking option, though some schemes might deem it a relevant comparator for some element of their own assessment.

Similar comparison requirements proposed and due for implementation by the government were designed expressly to promote the consolidation agenda[10]. We have reservations that comparison *alone* will prompt consolidation[11], and may also not improve VFM in enough schemes to make a material difference across the market. Moreover, as with the consolidation agenda, as the market evolves, 'good value' schemes will benefit as more members and employers are attracted to them. Therefore, we are sceptical that artificially highlighting or encouraging these market forces would be more impactful than continuing to support the natural evolution of the market.

Standardised VFM assessments and comparisons between schemes may be helpful for an automated small pots solution, in so far as it could help to establish a minimum standard whereby small pots could be transferred between a set of schemes. A formula for establishing this level, rather than based on trustee discretion, would be helpful to enable a small pots system. If a small

[10] Government response: Improving outcomes for members of defined contribution pension schemes - GOV.UK (www.gov.uk)
[11] FINAL - RESPONSE - DWP Improving outcomes for members of defined contribution pension schemes v6.1 (1) (plsa.co.uk)

pots transfer solution were solely based on trustee discretion, the cost of transferring these pots would likely be too high.

Generally, we urge Regulators and government to prioritise regulatory interventions that will have the most positive impact on retirement outcomes. Member outcomes are more likely to be positively impacted by efforts to improve pensions adequacy more directly, such as protecting employer contributions, increasing member contributions and enhancing support through the decision-making journey. Where schemes are found to be severely underperforming, for example evidenced by poor governance or controls, they should consider whether they can improve their performance.

Q13. Do you think a commercial benchmark is likely to emerge if these data are made publicly available?

It would be instructive to examine the benchmarks already used by various commercial providers, including consultants, whose job it is to assess the best value solutions for their clients (e.g. AgeWage, Langcat).

It may be that more public versions of these benchmarks would emerge over time, but we think this is only likely to happen where there's a commercial imperative for it to do so. It is unclear from the DP whether the Regulators plan to make reporting against these benchmarks mandatory, but if that were the case, which would come first, the benchmarks or the reporting? The benchmarks would be unlikely to emerge without the reporting but the reporting would not be possible without the benchmarks. Therefore, there may be a need for schemes to compare themselves against some other standard, such as their own objectives for instance.

Q14: Do you agree the quality of communication is a relevant factor to consider in VFM assessments?

This is a subjective question, as for some members this will be the most important aspect, whereas for others it will be irrelevant. That said, the greater the level of communication between scheme and members, the greater the level of engagement and this should in theory drive better decision making around, for instance, retirement age, quality of life in retirement, and in some cases lead to higher contributions.

Improved communications should also improve other factors such as governance. If a scheme communicates effectively with its members on all metrics, for instance ESG, the members are better able to hold the trustees to account over their decision making.

The PLSA would recommend that this area of communication is revisited as the FCA and the ICO place some barriers on proactive member engagement, and this may in turn have an impact on trying to ensure VFM. There is a danger that schemes might go beyond their remit and find themselves in breach of the regulations set in the Privacy and Electronic Communications Regulations (PECR).

In our Pensions Quality Mark (PQM), we consider the member experience. A PQM Scheme must ensure that members:

- Get the right information at the right time to make appropriate decisions
- Are informed about their membership of the scheme, how the scheme works, the benefits of membership and the progress of their savings
- Understand how their own actions, as well of those of the scheme, can influence their outcomes
- Are encouraged and helped to take action to secure better outcomes.

This is evidenced in a number of ways, including an analysis of engagement activity and its effectiveness and shortcomings, with a plan of actions for the coming year with their intended outcomes. A VFM metric based on a 'quality mark' like this might better provide decision makers with the information needed to make judgements on performance in this area.

Q15. Do you agree administration is a relevant factor that contributes to long-term VFM?

We agree that administration is relevant to long-term VFM. Good administration ensures the effective running of a scheme and is critical to a number of important functions, for example, the correct payment of pensions to members and providing information. As noted in the paper, administration is not always within the control of trustees, however, they should undertake evaluations of the effectiveness their administrators.

The DP doesn't consider what metrics of administration may be important to measure VFM. We asked our members which aspects of scheme administration (among the DC Code's listed service standards) they considered to be the most important in terms of VFM, and appropriateness of the default investment strategy came out as the main factor that should be considered.

Q16. Do you agree the effectiveness of governance is a relevant factor that contributes to long-term VFM?

Good governance is a relevant factor; research has shown that it has a substantial effect on pension fund investment performance, for example, Keith Ambachtsheer, of the Rotman International Centre for Pension Management, has estimated that schemes with robust governance structures outperform their peers by between 1 and 2 per cent a year[12].

[12] Keith Ambachtsheer, Pension Revolution: A Solution to the Pensions Crisis, p. 130, 2007

Governance is about the resources, structures and processes that support decision-making[13] and has a range of 'inputs' and 'outcomes' which can be measured. Inputs to good governance include appropriately qualified members of governance bodies, and the support of an appropriately resourced executive so that trustees can play the 'non-executive' role[14]. The outcomes may be a long-term investment strategy which maximises return within an appropriate risk budget, a positive member experience (including clear communication with beneficiaries, and the efficient operation of payment systems) leading to heightened member engagement with their pension.

It could therefore be argued that good governance can be assumed where outputs are positive. Good governance could in effect be double counted through assessing both the inputs and the outputs i.e. a specific governance assessment in addition to net investment returns. However, assuming the focus is on inputs[15], governance metrics could consider Board composition and structures which ensure schemes are accountable to members through timely reporting, that there are clear objectives for assessing scheme performance, and that executive support is available to advise the Board and execute decisions.

In our PQM Standards[16] we assess a well-run scheme as:

- Having the right mix of people with diverse and appropriate experience, skills, understanding and knowledge
- Employing tools for Board planning and reviews that ensure that the Board examines the things that really matter for delivering better DC pensions
- Understanding and interacting with members (both active and deferred).

This is evidenced in a number of ways, including an analysis of the diversity of the Board or committee and a record of an annual skills audit and review of effectiveness. A VFM metric could therefore take a similar approach in assessing these factors.

We agree with many of the areas of good governance outlined in the paper, for example, the importance of diversity and inclusion on Boards. However, the DP seems to suggest that good governance could be assessed by the ability of a scheme to have illiquid assets within its default strategies. We generally support the aims of the PFWG (which we are a member of) and the introduction of the LTAF. However, we would not endorse any particular asset class; good governance is the consideration of as wide a range of assets as possible, and the role of trustees is to decide on the balance of these according to the best interests of members. This may or may not include an allocation to long term investments, so any inclusion of illiquids in a governance metric must go no further than demonstrating their consideration.

[13] Gordon Clark and Roger Urwin of Oxford University and Willis Towers Watson describe good investment governance as 'the capacity of a pension fund to create value derived from the resources, structures and processes employed in the fund's investment arrangements' in Gordon Clark and Roger Urwin, Investment Governance: an overview of an underestimated subject – extracts from the Clark and Urwin research papers, Towers Watson, 2010

[14] PLSA, Good Governance – How to get there, A PLSA Discussion Paper, August 2017.

[15] PLSA, Good Governance – How to get there, A PLSA Discussion Paper, August 2017.

[16] https://www.pensionqualitymark.org.uk/documents/96_pqm-standards-january-2019-190619.pdf

Q17: In your opinion, are there any obvious service standards missing from the above list? Please explain how your suggestion contributes to scheme value.

We are keen to work with the Regulators as your thinking evolves to identify specific metrics and standards for service that may be needed, including any that are so far not covered with this DP.

Q18: Do you agree this is not a role for the Regulators at this stage?

We agree with the DP on this issue in that these are qualitative factors which lend themselves less easily to being measured. As such, measurement against common 'best practice' standards makes more sense than direct regulation, especially as more work will need to take place within the industry to establish exactly what schemes should be aiming for. The FCA/TPR should not make this an issue for regulation.

If regulated on, we would be concerned that VFM in terms of governance, comms and administration would become a 'tick box exercise', with providers simply having to satisfy a number of arbitrary criteria which may have little relevance to their own scheme type.

If supervised by the Regulators, schemes would naturally end up following a more prescriptive path, which in an area such as communications may well not be in the best interests of members, as it would limit the ability of schemes and providers to innovate and tailor their messaging to the specific needs of their membership.

Different types of scheme also need the latitude to provide different services for their members; certain schemes may mainly be made up of engaged savers with excellent pension provision, and as such their communications will prioritise complex modelling to enable members to analyse their situation and make decisions throughout accumulation based on changing circumstances. Another provider (e.g. a large master trust) will have a completely different membership profile, for whom the servicing and communications required could be simpler, but may also require additional employer facing services, for instance to ensure contributions are collected. We feel it would be very difficult to compare these two examples, especially with metrics, so those overseeing schemes will need sufficient flexibility to demonstrate value in this area as they see fit.

Q19: Would it be helpful to appoint a neutral convenor to develop a service metrics standard? If not, who do you think should create metrics on service in pensions?

A neutral convenor may in principle be a good idea, though a number of outstanding questions would first need to be resolved, for example, how the cost of the convenor would be shared without placing a significant burden on smaller schemes.

It is important that the Regulators take account of existing service metrics and standards in pensions. For example, the PLSA's PQM is an accreditation for workplace DC pension schemes that was originally developed in 2009 and completely revised in 2019. It recognises employers that are committed to supporting employees to save for retirement by providing pension contributions above the minimum automatic enrolment contributions required by regulation. Around 125 pension schemes currently hold either PQM or PQM Plus.

The core principles of the PQM standards are that a pension scheme should have:

- A commitment from the sponsoring employer to enrol all employees at minimum contribution levels
- An effective board
- A good quality default investment strategy
- An understanding of its members with an inclusive engagement strategy, and
- Support for members at retirement.

The Standards also set out what we consider to be good practice, and the types of evidence that a scheme can provide to demonstrate that it meets the Standards.

The service metrics standards envisaged by this DP appear to consider factors similar to those included in the 'member experience' standard (and some of the 'Board responsibilities' standard) for PQM. To meet the standard for 'member experience' a PQM scheme must ensure that members:

- Get the right information at the right time to make appropriate decisions
- Are informed about their membership of the scheme, how the scheme works, the benefits of membership and the progress of their savings
- Understand how their own actions, as well as those of the scheme, can influence their outcomes, and
- Are encouraged and helped to take action to secure better outcomes.

Q20. Do you think that over time independent certification against a standard is worth exploring for benchmarking service metrics? If not, what alternative arrangement would you suggest?

Please refer to our response to question 19 as it is unclear to us how this would be possible and robust without a neutral convenor in place, unless the Regulators would plan to 'independently' certify these standards or appoint a certifier that did so in their stead. The PQM is a simple benchmark that employers can use to demonstrate the value of their pension both to current and potential staff. The application and supporting documents are thoroughly checked by the PQM's independent assessors before the scheme can qualify. While the PLSA carries out compliance checks on a number of randomly selected schemes each year, can request additional information, evidence or clarifications, and so on.

Q21. Should we use the existing administration charges and transaction costs definitions in developing VFM costs and charges metrics?

In our view it will be important for the Regulators to review existing disclosure requirements in detail and build on these disclosures in developing VFM metrics in general, not just those for costs and charges. This is to ensure that additional disclosures needed to deliver metrics do not, through their own production, lead to unmerited further cost. It would be reasonable to assess and review the costs of disclosure as a component of any cost metric.

Similar to other answers, we believe it is very important to identify the audience for the disclosure, and the intended action the audience should take. For example, existing administration and transaction cost definitions are at least, in part, intended for members, whereas future VFM assessment metrics will be aimed at IGCs/trustees. Where intended for a particular audience it will be important to test that the disclosure is understood and having the desired effect; otherwise, such disclosures (and metrics based on them) are unlikely to be proportionate.

The existing disclosure of costs and charges, such as those using the existing definitions of administration charges and transaction costs, are likely to be more meaningful if and where comparison can be done in the knowledge of wider contextual information. This is likely to be the case for most cost and charges disclosures. Context is usually necessary, particularly when attempting to compare with other, different circumstances.

The Cost Transparency Initiative (CTI) is an industry standard for institutional investment cost data. It was launched in 2018 as a partnership initiative between the PLSA, Investment Association and Local Government Pension Scheme Advisory Board. These organisations, representing different interests within the pensions industry, have come together with a commitment to:

- promote understanding, raise awareness, and encourage full transparency and standardisation of costs and charges information for institutional investor
- cooperate in creating a new body (the CTI Board) to curate, test and update the framework set out in the final Institutional Disclosure Working Group's (IDWG) report (see below)
- deliver industry standards on cost disclosure.

The pensions industry has benefited from a trend towards greater transparency of costs & charges over recent years (for example, including but not limited to the LGPS Code of Transparency) – and the CTI helps consolidate this trend into one package of cost disclosure templates.

It is worth noting that the CTI framework is aimed at institutional investors and the information is not likely to be of direct interest to retail consumers (though summaries of the information are used in member communications and publications such as the Chair's statement). This is in part due to the degree of granularity/disaggregation provided by the templates.

However, although the templates were designed with cost management and, where appropriate, comparison of costs between providers in mind, the information provided may well be commercially sensitive and/or inappropriate to publish. In our view the CTI templates therefore help to demonstrate the difference in granularity and disaggregation between cost disclosure designed for use by decision makers as opposed to cost disclosure designed for public consumption. As such, depending on the audience and destination for these VFM disclosures, firms may simply be unable to provide the desired costs & charges information if they are bound by commercial confidentiality.

In general, developing cost and charges metrics should be considered carefully where it is possible that the employer is bearing some of the cost on behalf of the scheme or member. It would be perverse to either disincentivise employers from continuing to bear these costs, and/or for eventual disclosures to not fairly represent the value for the member of costs borne by the employer that they would otherwise pay.

Q22. Would splitting out the administration charges be a more useful metric? If not, are there other definitions you think would be more appropriate?

It may be useful to split out administration charges in order to look at the relative costs of fund management and pension administration. It could be argued that net performance metrics should reflect the fund management cost, therefore, by not having a split-out administration charge you could be counting these twice. However, it may be difficult for schemes to get hold of this information depending on the charging structure in the scheme. Some schemes will have an 'all-in' fee which will be harder to separate out costs.

Additionally, disclosures should follow existing requirements and definitions for reporting of costs and charges. We would question the purpose of splitting out the administration charge for a VFM metric and the behaviour that this is trying to drive.

There are several barriers which may prevent trustees from using more granular information from driving down costs. These include the complexity of information, governance time and expertise needed to review the charges, and as with much cost information, it is most powerful when considered as part of a wider trend or efficiency analysis. Therefore, further breakdowns are not appropriate as part of a VFM measure.

Q23. Do you agree we should introduce benchmarks for costs and charges?

and

Q24. What are your views on our suggested options for benchmarking costs and charges? If not these options, what benchmarks should be used?

The merits of the introduction of benchmarks for costs and charges should, in theory, be similar to those that are intended and designed to measure (non-net) performance; in isolation these benchmarks would provide an incomplete picture of VFM.

Benchmarking can work well as a mechanism to improve outcomes where competitive tension can act on a few key measurable metrics that can act as proxies for good value. However, it is difficult to see how it could work across the entire pensions market, which includes very different structures and actors, with very different responsibilities and degrees of control over the outcomes.

Benchmark comparison is mainly helpful where this can be done in a 'class' or group, not in isolation as 'objective' comparison is likely of very limited use. Particularly, the DP makes reference to poor value legacy products and it is difficult to foresee how cost and charges benchmarking, as a sole mechanism, could make a significant difference to this issue. Notably, some legacy solutions are retained in place because it is complex or impossible for providers or schemes to justify a move from these, and/or indeed cannot legally switch members without their consent to do so.

For example, in recent research undertaken by the PLSA on behalf of the CTI, respondents felt that additional help to understand, and potentially compare, cost information would be a welcome addition to the suite of support provided by the initiative. However, there are several difficulties with this. Firstly, the CTI does not gather cost information centrally on costs; the templates are free to download and use and information flows directly between asset managers and schemes (or other institutional investors, where applicable).

Scale has, in the past, been suggested as a key determinant of some cost factors – though crucially not all and not over time. It is unclear how some kind of weighted average benchmark for costs and charges could be established that could sufficiently take account of scale, especially where scale is not immediately obtainable or achievable for all schemes (for example, where consolidation is impossible or highly disadvantageous for the member as some benefits have associated protections).

APPENDIX: SUMMARY OF VALUE FOR MONEY ROUNDTABLE

- On 18 November the PLSA held a Roundtable with members to discuss the TPR/FCA Discussion Paper – Driving Value for Money in defined contribution pensions.
- A number of areas were covered:
  - The purpose and likely impact of ideas proposed on value for money
  - The role of the regulators
  - Benchmarks across the three value for money components
  - Parallel, contradictory and/or similar legislation and regulation
  - Reporting including disclosure for trustees, employers, savers and regulators.

THE PURPOSE AND LIKELY IMPACT OF IDEAS PROPOSED ON VALUE FOR MONEY

- Participants felt that the Discussion Paper should be aimed at governance bodies rather than scheme members. It should be published in a format so that it can be analysed. However, there was a question over who should do this analysis (i.e. schemes, consultants or Regulators) and how the information would be used.
- A Value for Money metric should focus on one audience – i.e. governance bodies – rather than several audiences.
- Participants were pleased that the DP took a more holistic view of value and did not only focus on cost and charges. However, more emphasis could be placed on the scheme administration, governance and comms element.

THE ROLE OF THE REGULATORS

- Participants felt that some form of certification for the Scheme Administration, governance and comms element was necessary, otherwise schemes would not know what a minimum benchmark was. However, this is not something the regulator should be leading on. Participants felt that various industry initiatives could develop minimum standards e.g. STAR on transfers. A neutral convener could also set minimum standards, however, there were questions over how this would be financed.
- It was noted that communications can be personal to the needs of a scheme and therefore there is a need to assess what schemes are doing in the context of what members need.

BENCHMARKS ACROSS THE THREE VALUE FOR MONEY COMPONENTS

- It was discussed that with benchmarking different components would need weighting. It needs to be clear what benchmarks are applying to and the weighting attributed to certain aspects.
- It was suggested that a disclosure template might be better rather than benchmarking as the governance process is not a black or white process on benchmarking.
- It may be beneficial to build a framework for how trustees can assess what they are doing rather than a prescriptive set of metrics. This would also give more flexibility to trustees to make a judgement.

PARALLEL, CONTRADICTORY AND/OR SIMILAR LEGISLATION AND REGULATION

- There was group was clear that any VFM metric should avoid duplication of work with existing or similar legislation and regulation. Schemes have some processes in place already and there is no appetite to start again on that work. It should be holistic within the current regulatory framework.
- A VFM metric should reflect legal requirements on trustees. There were questions raised over how often a VFM metric should be measured, for example, an annual process may be too small a window for trustees to properly assess changes.

REPORTING INCLUDING DISCLOSURE FOR TRUSTEES, EMPLOYERS, SAVERS AND REGULATORS

- Participants generally agreed that it is preferable to consider age to retirement rather than specific ages to provide investment data. Adjusting for risk was useful as different levels of risk are taken within the glide-path. It was also noted that a specific point rather than a range along the glide path would be better as investments can vary significantly within the ranges given.