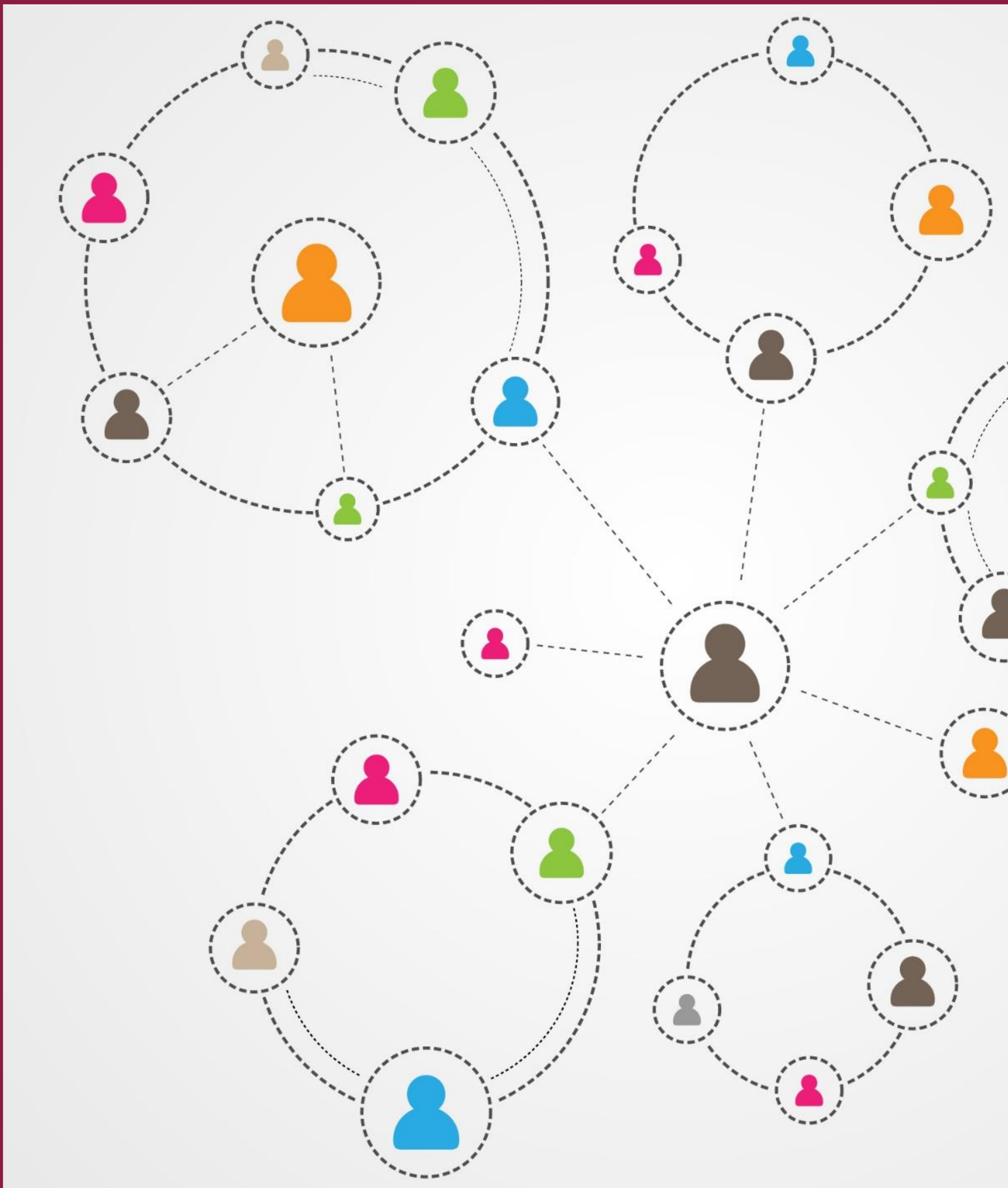

PASA
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PASA Consultation Response

The Pensions Regulator & Financial Conduct Authority's joint discussion paper on assessing Value for Money (VFM) in Defined Contribution schemes

December 2021

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1. Introduction – About PASA

The Pensions Administration Standards Association (PASA) was created to provide an independent infrastructure to set, develop, guide and assess administration standards.

PASA acts as a focal point and engages with industry and government to create protocols for understanding good administration - but also appreciates there's no one size fits all. PASA develops evidential Accreditation practices allowing benchmarking across and between the industry regardless of how the administration is being delivered.

As well as raising the profile of pension administration generally, PASA focuses on three core activities.

1. Defining good standards of pensions administration relevant to all providers, whether in-house, third party or insurers
2. Publishing Guidance to support those standards
3. Being an independent Accreditation body, assessing the achievement of good standards by schemes

There's no organisation providing such services across schemes, yet there's a demand for evidence of service quality from scheme trustees, sponsors, administrators, insurers, savers and regulators.

About PASA Accreditation

PASA Accreditation is open to all corporate members of PASA (DB, DC, trust-based and contract-based schemes).

PASA Accreditation is granted following an independent evaluation and assessment process, which includes on-site visits and the review of documentation to evidence controls, procedures, process, staff development and contractual positions with clients.

Full details on PASA can be found by visiting www.pasa-uk.com

2. Summary of PASA's view on the Discussion Paper

PASA strives to improve standards and saver outcomes. We strongly support the concepts of both value for member and value for money (VfM). However, with the advent of larger consolidated pensions vehicles, it's clear while value for member and VfM have many similarities, VfM doesn't always result in the best outcomes for savers.

Our responses have concentrated on the practical aspects of VfM and we fully support The Pensions Regulator (TPR) and Financial Conduct Authority (FCA) in their attempts to focus on this area. However, the discussion paper demonstrates the issues the industry must grapple with in terms of defining meaningful measures, working on transparency, and making use of what is already in place – rather than reinventing the wheel.

3. Consultation questions and responses

Note: PASA's response focuses on the administrative aspects of the discussion paper covered in questions 14 to 24.

Q14 - Do you agree the quality of communication is a relevant factor to consider in VfM Assessments?

Absolutely. The DC marketplace has changed dramatically over the last number of years and savers expect to have a greater wealth of information available to them on which to make informed decisions about their pension provision. This information needs to be transparent, accessible, clear and understandable - in plain English - and presented in a member-friendly format. The COVID-19 pandemic has led to greater reliance on online access both in obtaining information, and submitting requests and questions. Although traditional communication channels such as post and phone still need to be catered for, online communication channels such as email, instant messaging, video statements, video calls, etc. will become the norm and an expectation. Through these mediums, communication is available 24/7.

It should be acceptable for DC pension providers to be measured against the criteria of channel mixture, accessibility, presentation and format, usefulness and understandability.

Q15 – Do you agree administration is a relevant factor contributing to VfM?

We strongly agree. Poor administration doesn't just create a poor impression, but could reduce savers' confidence in how a scheme is run and managed. It could also result in delays to processes and impact on financial returns realised if there's a hold up in investing or disinvesting funds. The increased effort associated (dealing with issues or increased requests from savers or advisers where issues arise) with poor administration, would likely also increase servicing costs and therefore impact on outcomes through fund charges.

Irrespective of how administration services are provided, to ensure VfM is achieved, schemes should make sure appropriate contractual service measures are in place. These should be regularly measured and monitored as part of regular scheme governance.

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

Yes. There's an expectation trustees, scheme managers and to some degree, scheme sponsors, are experienced and knowledgeable in the management and oversight of DC schemes and can govern the relevance and effectiveness of the way the scheme's VfM is measured, checked and reported.

Although savers may not be particularly aware of the specific credentials or training undertaken by trustees and scheme managers measuring the effectiveness of governance, it will instil greater confidence knowing there's strong governance overseeing the long-term VfM of a scheme on their behalf. These measures must cover both investment performance and administration standards as a minimum.

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

The 'Customer Service and Scheme oversight' is the weakest of the measures, as it largely focuses on features rather than outcomes. Investment Performance and Costs and Charges are underpinned by clearly defined, and 'benchmarkable' numbers. The Customer Service and Scheme oversight element of the VfM proposal is subjective in nature. The consultation paper says 'Good communication may encourage members to save more or engage more effectively with the choices they have to make, thereby having a real impact on 'long-term member outcomes'. However, it doesn't define what 'good communication' means and what 'long-term member outcomes' should look like. This should be the 'value' against which the other two elements are measured.

Improvements can be made in how we define and measure value. Focusing on product features, such as communication, administration and governance, while important, aren't necessarily directly correlated to the ability of a scheme to deliver good outcomes. The outcomes will result from a unique interplay of these product features and capabilities. It would make more sense to define and measure good member outcomes, removing subjectivity from the process.

For example, positive and measurable actions related to good outcomes could include:

- Average contribution levels above the regulatory minima
- Prevalence of AVCs
- Prevalence of consolidation, particularly in the lead-up to retirement
- Choices made at retirement
    - Encashments
    - Flexible access drawdown
    - Annuitisation
- Interaction with Selected Retirement Ages
- Instances of making beneficiary nominations

Each of these items can be measured and relate very closely to good outcomes for savers:

1. Those who pay more in will get more out. Those who choose to pay more voluntary contributions demonstrate greater engagement levels
2. We know people make different choices over larger sums of money than they do with smaller pots. Small pots make for less well-considered decisions and so those schemes evidencing more consolidation are statistically facilitating better decision-making
3. Savers who've actively set a glide-path in line with their actual anticipated retirement age (not just a default retirement age) not only demonstrate more engagement with planning, but are also protecting themselves from market volatility at the time when they need the protection most – or benefitting from equity growth when they aren't sufficiently close to vesting
4. Savers choosing to draw sustainable incomes are more likely to achieve better outcomes than those simply cashing in
5. Savers nominating a beneficiary are better protecting their loved ones in the event of death before retirement

Each of these metrics, could be collated into an outcomes score and benchmarked against either other schemes, an aggregated score or preferably a baseline score. The scores can be monitored for trends and continuous improvement. This would provide a method to define exactly what 'value' means. Against this measure, the investment performance and charges would provide the counter-balancing factor which, when compared, offers a true measurement of VfM. It also addresses the situation the consultation paper identifies when it says, 'We want to avoid firms competing to provide unnecessary additional features'.

A good outcome for savers is having enough money to maintain their desired lifestyle, without running out of funds too soon. Low charges and good investment performance, while important, aren't the only direct indicators of these outcomes. You could have low charges and good investment performance and still not have enough money and run out too early. The aim of the exercise should be to define value (which we suggest is the definition of good member outcomes) and the VfM determination comes from comparing the value outcomes measures with the costs and investment performance.

It's possible those schemes offering the higher charges and consistent (but above average) investment performance will be those delivering better outcomes. So, we suggest there aren't services standards 'missing' as such, but the Customer Service and Scheme oversight element of the VfM assessment should be defined more clearly and constructed around a set of measurable outcomes rather than product features.

Q18 - Do you agree this is not a role for the regulators at this stage?

A holistic approach should be taken when viewing VfM and wider factors should be considered which contribute to better VfM for savers. An all-inclusive approach would include a number of factors to consider, it wouldn't be sensible to restrict schemes to having to meet regulators' standards/metrics.

It would be more beneficial to allow schemes to demonstrate their VfM in their own terms outlining their specific metrics, considering their membership cohort, and the factors the scheme and trustees agree should be prioritised.

The metrics, data and reporting are more qualitive than quantitative and therefore more difficult to regulate. VfM could be comparable to other arrangements, but a benchmark to compare an overall score would be difficult as criteria, such as ESG, investment performance/risk, communication, etc. are prioritised differently.

There's additional difficulty in having more than one regulator, to install a number of different standards or metrics to suit all the varying types of schemes and still be able to compare schemes' VfM.

It would be a detriment to the pensions industry if we end up with such an important topic as VfM turned into a tick box exercise. Unfortunately this is often the reality for the Chair's Statement, where schemes must focus on meeting all TPR's strict reporting criteria and lose sight of the main objective - for savers to have the best version of the scheme possible.

There's also a possible cost on schemes to consider in establishing new controls, procedures and reporting where there's no obvious benefit to the scheme or saver in complying with fixed regulatory VfM requirements.

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 plus Q20-24?

No one person or organisation who would understand the breadth and detail of VfM service standards could be considered 'neutral'. By definition, they would need to be either a regulator/auditor or a provider of services. This role could be fulfilled by an independent body with full input from the industry, including regulators.

As far as the detail of benchmark criteria are concerned, there are two cases or scenarios:

1. Master trusts and regulated contract based Automatic Enrolment plans
2. Single or associated employer DC plans

Regulation and market expectations are much tougher on the former. Single or associated employer DC plans typically have much tighter demographics than multi-employer schemes (e.g. members largely based in the same location), they understand their members and their interests in much more depth, and typically have a sponsor which is much more engaged with its employees' perspectives of retirement planning.

Multi-employer schemes however, often have significantly greater resources and are subject to tighter oversight (regulators, advisers, press and sponsoring employers).

Even within the master trust market there are conflicting views as to what constitutes an appropriate service metric. At one end of the spectrum, attempting to use data to distil all relevant factors into one number. This has the undoubted benefit of simplicity but doesn't address the diversity and complexity of what constitutes VfM for differing markets, or the priorities of different schemes when considering VfM. A scheme offering 'good' VfM for a large employer with well paid, financially sophisticated employees and high contribution rates is likely to be effective at addressing savers' needs. A master trust also offering 'good' VfM, but catering for large numbers of small employers and their employees, where members have low earnings, minimum qualifying contributions will probably show low levels of engagement.

There are vast differences in member demographics within the master trust market. Nest, TPP, Now and Smart have large numbers of low paid employees. Conversely, master trusts provided by consultants actively select from the 'high end' employers. There are currently 10 hybrid master trusts providing combinations of DB and DC benefits. These include some of the largest pension schemes in the UK, others in the charity sector and the FCA itself. It would be unreasonable to consider a 'one size fits all' approach as this would be too narrow and a limited measure of VfM across this spectrum of provision.

This doesn't mean non-exhaustive high-level criteria shouldn't be set, but the relative weightings applied and detailed factors to be analysed need to be flexible. For instance, all schemes should consider ESG requirements, but this doesn't mean this would lead to an identical implementation approach in each case (e.g. it isn't plausible to expect a nuclear power scheme to exclude investments tangential to nuclear power under ESG grounds). Schemes should also assess the objectives and views of their membership; this could lead to differing investment strategies to suit and, therefore, variable scores.

At the highest level, the key factors relate to the process.

There's an almost infinite list of measurements, but focus should be on priorities relevant to the specific scheme membership:

- The weightings applied (some factors are more important than others)
- The benchmark criteria applied – these can be external benchmarks (e.g. FTSE all share performance, PASA service standards, communications reading age etc)
- Scores relative to those benchmarks (the most subjective area but schemes can and do, get external validation from advisers)
- How answers to members, employers, regulators, advisers, colleagues and the market generally are articulated

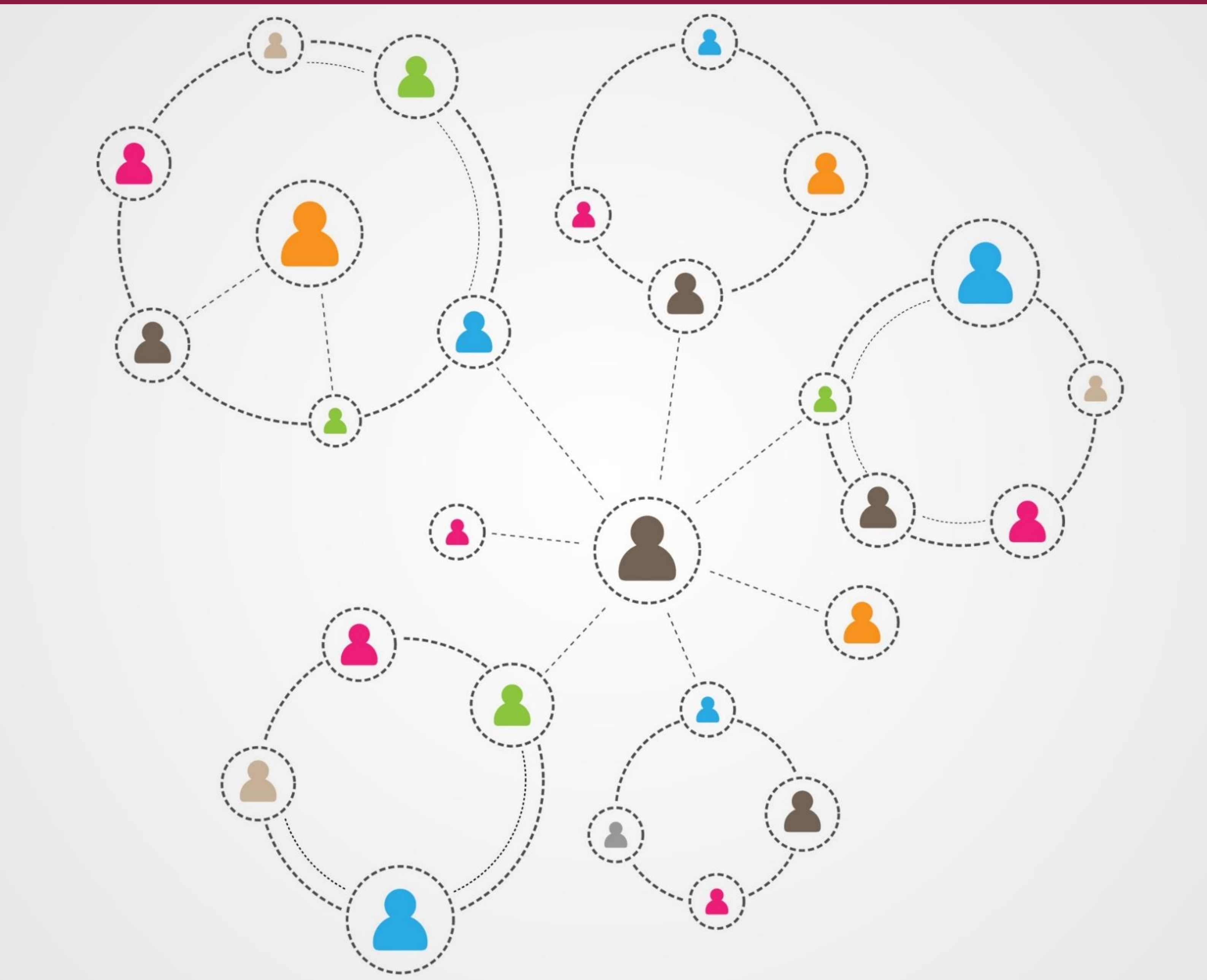
Because of the variability of the potential metrics, it's difficult to see how standard benchmarking could be applied in the current market other than by way of a 'pick 3 from 6' style approach which could lead to even greater confusion.

One clear major element to the criteria must be costs and charges – they're the flipside to the value considerations demonstrated. Given there are already several definitions: AMCs, TERs Member Borne Charges, transaction costs (including single swinging process) any new measures shouldn't be introduced unless there's a clear governance shortfall. The charges referenced could be both specified by type of charge and aggregated for a typical member scenario (or scenarios). This should make it clear why any variable charges apply and what the benefit is to any saver paying those charges. Given the variation in possible charges depending on circumstances (and the likelihood of offsetting between elements within charging structures), a benchmark is neither beneficial to savers or feasible (except the overall charge cap).

Proxies will sometimes need to be found for what needs to be measured – to calculate reading age of communications and measure whether they get opened, read, and actioned, but no one can know if they're actually understood or if savers made the 'right' decisions based on them. It's also important to avoid a situation where there's a 'tick-box' mentality which introduces additional processes, but doesn't lead to an improvement in governance.

The cost impact of compliance is also a relevant factor to consider in the establishment of a new regime. It's one thing to incur additional costs in establishing new processes or systems having a direct benefit for savers, but quite another for schemes to be incurring large adviser fees to assess whether they are complying with VfM requirements. It's a concern the solution may have an adverse effect and be detrimental to savers.

To specifically address the question 'Who do you think should create metrics on service in pensions?'; there are relevant industry specialists (including PASA for administration metrics) which would be the best arbiters of good metrics. However, these should be aggregated and checked for consistency by the overall responsible body.



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