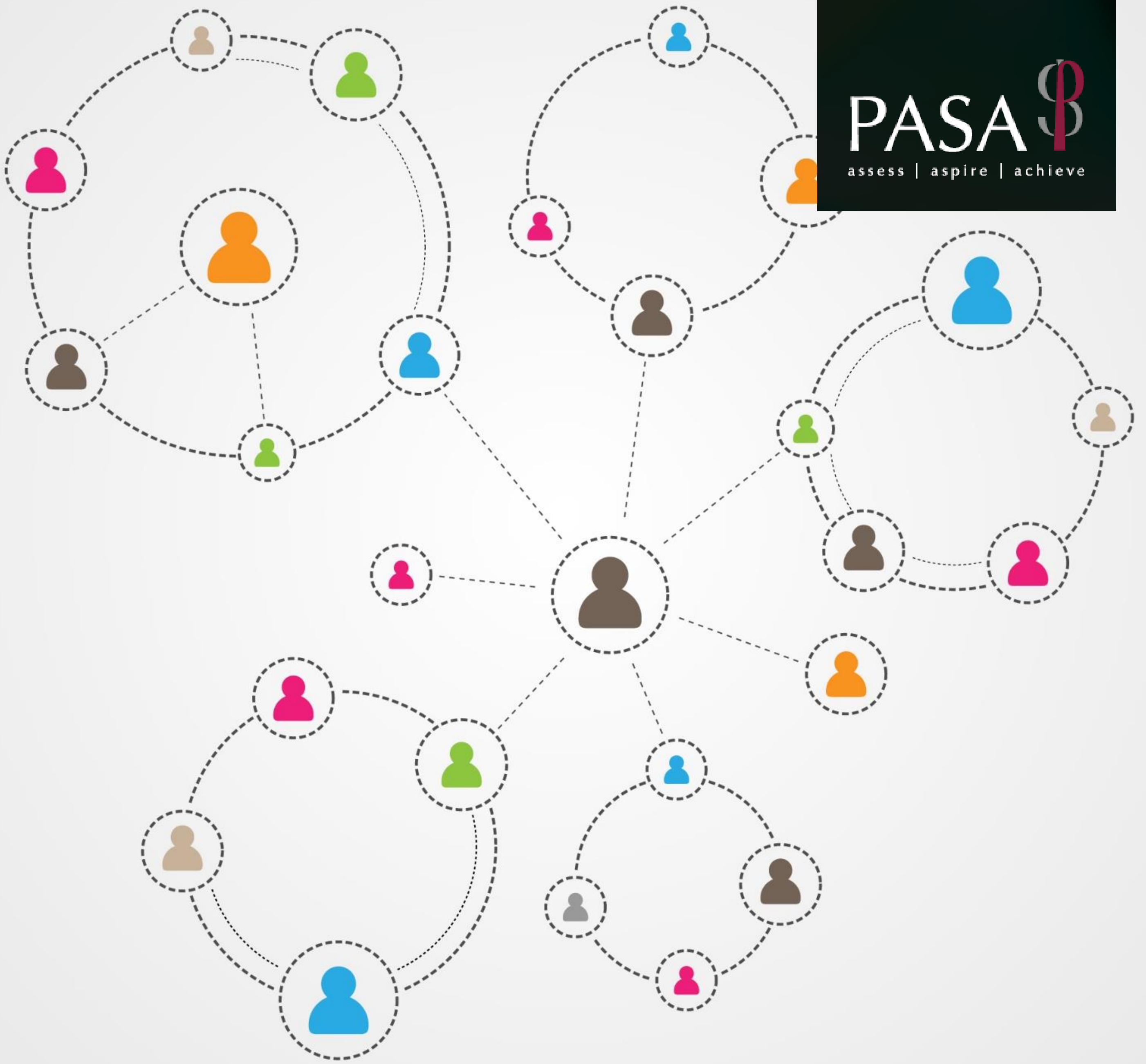

PASA Consultation Response

Response to the DWP ‘Value for Money: A framework on metrics, standards and disclosures (VFM) framework’ consultation

March 2023

Acknowledgments

PASA is grateful to the authors of the response and members of the PASA Value for Money Working Group (VFMWG) and their employers.

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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.

1 Summary

PASA strives to improve standards and saver outcomes. Following on from our response to the Financial Conduct Authority (FCA) and The Pensions Regulator (TPR) Value for Money Discussion Paper in December 2021, we strongly support the concept of VFM. Our responses have concentrated on the practical aspects of VFM and we fully support TPR and the FCA in their attempts to focus on this area. However, the VFM proposals are currently complex and likely to result in significant cost and additional burden for schemes. We urge a simplified approach, to balance the need to convey a transparent and meaningful comparison with the burden on schemes.

2 Consultation questions and responses

PASA's response focuses on the administrative aspects of all questions in the consultation except for questions 2, 3, 4, 5, 6, 7, 26 and 22.

Q1: Do you agree with the proposed phased approach?

We agree with a phased approach and are mindful of balancing the reality of collating complex information with the usefulness of industry wide comparisons. In order to fully support a phased approach, it would be useful to understand timelines for both phases.

Obtaining data in relation to the assessment of legacy schemes/products could be significantly more challenging in a number of areas. We recommend decoupling legacy schemes/products from Auto Enrolment (AE) Schemes within Phase 1, to allow the work on the more straightforward arrangements to progress more quickly.

While savers aren't the initial audience for the VFM assessment output, employers are closely linked with savers and they could become aware of this information. We note decumulation and self-select funds aren't included in phase 1, but these savers are arguably representative of the more engaged saver cohorts.

Q8: Are there any barriers to separating out charges in order to disclose the amount paid for services?

It's become common for retail pension products and platforms to unbundle charges so savers can see the product wrapper charge (often referred to as the administration charge) and separately, the fund charge. This is particularly helpful when savers, sometimes working with professional advisers are assessing whether or not to invest in more complex, or more actively managed, funds which tend to carry a higher charge, or to invest in simpler and more passive funds which tend to carry a lower charge

While separating the investment element of the scheme charge from the administration element should be notionally possible, it won't be a simple case of running a report. It's probable different schemes and providers will adopt different approaches to creating this notional split, which would leave us comparing 'apples with oranges'.

An 'apples v apples' approach could be taken when the investment performance, net of all charges, is used. This approach shows the actual return a saver will benefit from when all charges have been deducted, whether bundled

or unbundled. However, as explained below, because of different approaches to pricing, a like-for-like approach may only be possible within 1) mono-charge schemes, 2) duel charge AE schemes and 3) multi-charge legacy schemes.

Like many industries around the world, the asset management industry operates a practice of differential pricing. When agreeing a price with a scheme or provider, they often require the agreed price not be disclosed through a contractual arrangement.

If there's a desire to explore investment charges as ingredient component distinct from other charges, Government and Regulators should explore the extent to which contractual commitments restrict the disclosure of fees paid to specific asset managers, as this could also be an inhibitor to the unbundled approach to the analysis.

Q9: Do you have suggestions for converting combination charges into an annual percentage? How would you address charging structures for legacy schemes?

The treatment of combination charging structures which are permissible for AE should be considered. This is separate from legacy charging structures which can be considerably more complex.

The challenge for all pension scheme operators is to set a level of charge which will, over time, tread the delicate line of i) being competitive in terms of saver outcomes, while ensuring ii) the long-term solvency of the scheme or product. To do this, scheme operators project all of the costs which they're likely to incur, then, based on the number of schemes, savers and assets under management, which they also predict over time, set a level and shape of charge they believe will meet both these challenges.

There are two broad approaches to this; mono-charge and duel-charge.

For mono-charge arrangements, it's common for schemes to underwrite each client (employer) to set a level of charge expressed as a percentage over time. This will cover the costs incurred in £s over time.

Example 1: - The average pot after 10 years, for an employer who pays minimum wage, has a contribution basis of 8% of band earnings and where the average term of employment for a worker is 1 year, might be c£500. Ignoring investment growth, for simplicity.

Example 2: - The average pot size again after 10 years, for an employer whose workers are mainly higher rate taxpayers, where the combined contribution is 15% of full earnings and where the average term of employment is 10 years, might be c£100,000. Again, ignoring investment growth.

In our second example, applying a scheme charge of 0.2% would generate an income of £200 per annum, per pot in year 10, while applying a charge of 0.75% in our first example would generate income of only £3.75 in year 10.

For mono-charge arrangements, each saver with a particular employer, will experience the same reduction to their fund in percentage terms each year. However, one workforce could experience a different level of charge relative to another workforce, largely based on the demographics of the workforce and the generosity of the employer.

For dual-charge arrangements it's the opposite. Here, it tends to be each employer/workforce which has the same level of charge and structure applying. However, the impact of the combination of charges will impact different savers/employees in different ways.

For example, in an arrangement which charges an AMC of 0.3% and a monthly charge of £2 per month (£24 per annum), a pot of £500 would experience a percentage reduction of 5.1%, but someone with a pot of £1m would experience a charge which is very close to 0.3%.

In another example, where savers are charged an AMC of 0.3% and 2% of each contribution, a saver close to retirement with a pot of £100,000 would experience a percentage reduction very close to 0.3%. An older worker joining a year before retirement and building up a pot of £500 during the year could experience a percentage charge of close to 2.1%.

When comparing mono-charge arrangements, where the impact of the charge in percentage terms varies at employer level, it could make sense to adopt a cohorts-based approach. So, the VFM applying to employers with similar characteristics can be meaningfully compared.

When comparing duel-charge arrangements, where the percentage impact of the charge varies at employee level, it could make sense to express the 'range' of potential charges.

In legacy schemes an even more complex combination of charges can apply, which include:

1. Policy Fee – a monthly or annual amount, usually applied as a pounds and pence charge
2. AMC – a % of the pot size which is expressed as an annual percentage but deducted on a more frequent basis
3. Allocation Rate – a reduction applied to each monthly contribution, single contribution, or inbound pension transfer. For example, an allocation rate of 98% means 2% of all 'money-in' is taken as a charge
4. Bid/Offer Spread – here the price at which units are bought is different to the price at which units are sold. For a bid/offer spread of 5%, the pension provider would gain 5% on the buying and selling of funds within the pension, adjusted for market movements
5. Initial Units – here a level of charge applies to 'investment units' purchased, for a period of time. Let's say 15 years. A contribution made in January 2000 would bear the charge until December 2014, with no charge applying from January 2015. The following month's contribution would bear a charge until January 2015 and would bear no charges from February 2015 onwards
6. Exit Charge – a reduction applied (usually as a percentage) if the saver exits the arrangement before a set point in time

This combination of charges in older products, means the effect of charges varies from one saver to another, but they also vary for the same saver over time, and can also vary for a saver depending on what actions they take. For example, a saver who stopped making contributions over 15 years ago, might be experiencing very low charges indeed, but if they started switching investments, they could see their charges increase due to bid/offer spreads.

Legacy pension products can also include benefits not available today on grounds of expense. Two very valuable types of benefit are i) guaranteed growth benefits and ii) guaranteed income benefits.

A guaranteed growth benefit could entitle a saver to a minimum level of growth of say 4% per annum, or a guarantee which means the value of a pension pot can never fall over the course of a year. The value of these benefits are highest during bear markets and lowest during bull markets.

A guaranteed income benefit might guarantee an annuity rate of say 1/10, whereas today a rate of 1/20 might be more realistic. This means a pension pot of £100k could secure an annual income of £10k, as opposed to just £5k in the open market. The value of such a guarantee depends on 2 things:

1. Proximity to retirement/annuitisation: For example a saver who is 10 years from retirement would need roughly 7% 'additional' investment growth OR a charge of roughly -7.0% in order to achieve the same level of income without the 1/10 guarantee. However, a saver who is only 2 years away from retirement would need around 50% 'additional' investment growth, or a charge of -50.0% to achieve the same level of retirement income

2. Retirement journey: For a saver who intends to annuitise, the value is set out as in 1) above. However, for a saver who intends to take a flexible approach to retirement using income drawdown, the value of the guarantee is 0% over all durations

For legacy schemes, it makes sense to calculate the equivalent percentage reduction (or reduction in yield) using a range of model points, where the range is sufficiently granular to cover all material charge structures, all material retirement savings behaviours, and all material decumulation options.

It may be challenging to make meaningful comparisons across mono-charge, dual-charge and multi-charge arrangements, but it's difficult to see a basis for making like-for-like comparisons across all 3 charge structures without collating an extremely complex amount of data and placing a very costly burden on scheme administrators.

Question 10: Do you agree with our proposal to provide greater transparency where charging levels vary by employer? Do you agree that this is best achieved by breaking down into cohorts of employers or would it be sufficient to simply state the range of charges?

From an administrative perspective, it makes sense for mono charge schemes which are underwritten (i.e. where one employer can have a different charge to another employer) to be split into cohorts based either on the number

of employees or the assets under management per employer. Some new reports may be required to group information in this way.

For dual charge arrangements, the effect of charges will vary by employee rather than by employer and for these arrangements it would make more sense to express the minimum and maximum reduction in yield for each scheme or product. It wouldn't be necessary to do this for each employer or group employers into cohorts.

For multi-charge legacy arrangements, the most pragmatic approach would be to create a number of model points to be applied to each scheme/product, with a reduction in yield calculated for those model points. It wouldn't be necessary to do this for each employer as the model points would apply equally across all employers within the same overarching scheme or product.

There may be value in splitting the market into cohorts reflecting the demographics of employers and their workforces. We don't see any additional administrative impact if this was to form part of the eventual framework.

Question 11: Are these the right metrics to include as options for assessing effective communications? Are there any other communication metrics that are readily quantifiable and comparable that would capture service to vulnerable or different kinds of savers?

While these metrics are intended to be a starting point, they aren't sufficient in demonstrating good communications. Other metrics such as types of communications sent and availability of the website may be easier to capture.

The first metric proposed isn't an effective measure of the value of communications. Schemes may communicate extensively with savers and still not be able to get them to engage beyond a certain threshold. This may inadvertently show some schemes as having poor VFM, despite perhaps offering good quality and effective communications but not meeting the quantification metric.

The second metric may be easy to obtain for larger schemes, which run Net Promoter Scores regularly, and saver surveys. This may be more difficult to obtain for small and medium-sized schemes, especially if email addresses aren't available for everyone.

In terms of whether or not there are other communication metrics, we could look to other ways to track outcomes. Lagging indicators are probably the most useful metric for measuring outcomes, but tracking lagging indicators for pension products is very challenging as stated in the framework document. What we can do is create much more focused leading indicators of good saver outcomes. We can start to track behaviours in much closer proximity to good outcomes. Statistical evidence shows savers tend to draw money out too readily, they draw it too soon and when they do set up an income they often draw way too heavily and it runs out too quickly. Savers also tend to make isolated decisions, keeping pension pots fragmented.

We know savers aren't interacting regularly with their pension pots, or thinking about when they want to draw an income - as selected retirement ages are hardly ever reviewed. We also know very few savers think about who their money would go to in the event of death before retirement - with less than 15% of savers making a death benefit nomination on their policies.

Consideration of the following should be made when setting meaningful communication metrics:

- those putting more money in to their pension stand a greater chance of amassing more money
- those setting up an income stream (like a drawdown policy for example) rather than cashing out are less likely to run out of income in retirement
- those thinking about when they want to draw an income (their Selected Retirement Age), and then aligning their investment strategy to it deliberately, are less likely to see an unexpected drop in their pension fund due to market volatility, at the crucial point they want to fix their income levels
- look at who is managing their pension arrangements as a cohesive plan and consolidating, rather than a disparate collection of legacy pots

While these considerations around metrics are still leading indicators, rather than lagging indicators, they're much more specific and linked directly to measurable behaviours – they're not simply a list of product features. It would give us a set of measures allowing us to objectively compare one product against another, without relying solely on charges and investment performance. Clear and uniform definition of administration measures and these services alongside communication would be beneficial.

All schemes will be required to maintain and review a large set of statutory and administrative communications. For a great many workplace schemes, the new Consumer Duty directive will require administrators and trustees to demonstrate these communications are understandable, accurate, jargon-free and relevant. The extent to which compliance with the Consumer Duty requirements underpins alignment with the VFM requirements would be useful for scheme administrators to understand.

Question 12: Are these the right metrics to include as options for assessing the effectiveness of administration and/or are there any other areas of administration that are readily quantifiable and comparable?

The metrics are appropriate and demonstrate a minimum level of good administration VFM. We acknowledge in our response to Question 11 these metrics are just a starting point, as many schemes and IGCs/providers could easily meet these metrics, and therefore comparison between schemes based on administration alone would be difficult.

Other areas which may be considered are general adherence to SLAs (bearing in mind SLAs are calculated differently across providers), level of complaints and resolutions and online capabilities (such as being able to change details online rather than having to write a letter).

Question 13: Do you agree with a decentralised or a centralised approach for the publication of the framework data? Do you have any other suggestions for the publication of the framework data?

We recommend a centralised approach as the ultimate target. This would allow a 'one stop shop' where comparison information can be viewed at a glance rather than having to extensively search for it.

However, in line with the phasing approach, this should be considered towards the end of the final phase. In the meantime, we recommend a decentralised approach while a greater understanding of what the target centralised approach would require and look like can be considered.

There may also be some commercial opportunities for a centralised approach, meaning the phased approach will allow for an understanding of these opportunities and to fully understand any requirements before creating a tender opportunity.

Question 14: Do you agree with the proposed deadlines for both the publication of the framework data and VFM assessment reports?

Publication dates and the end point for net returns should be as close together as possible, notwithstanding the technical difficulties this could create. This allows savers to get the most up to date figures and allows the regulator to act more quickly. If the phased approach is taken as schemes undertake this more frequently, the gap should be reconsidered at the end of each phase and reduced if possible.

As schemes do this, they should be designing a slick process which can be rerun frequently. In line with our response to question 13, and the phased approach, a longer period at the start should be allowed, to give time to understand the technical issues and resolve them, with the aim of closing the gap towards the end of the final phase.

Allowing schemes additional optional publication points to show progress should be considered so a 'bad result' doesn't impact a scheme for a longer period than necessary.

Question 15: Do you think we should require comparisons against regulator-defined benchmarks or comparisons against other schemes and industry benchmarks?

The industry naturally evolves over time with investment markets, whereas regular-defined benchmarks may be too rigid, and not in-keeping up with latest thinking. Industry benchmarks may also encourage competition over time. From an administrative perspective, clear benchmarks and standards would improve delivery and provide clarity to the saver.

We recommend values are re-baselined periodically (e.g. every 5 years), to encourage continuous improvement.

An understanding of average delivery times to action standard procedures such as a pension transfer, compliant resolution, fund switch, UFLPS payment would be useful data to allow a scheme to track comparative effectiveness.

Question 16: Do you agree with the step-by-step process we have outlined, including the additional consideration?

In principle this is a thorough process, however we have reservations about the phrasing within Step Three of overall cost of services. Given the starting metrics are intentionally quite limited in scope, this may cause confusion for savers when indicating a poor service value due to a potentially higher cost. A higher charge doesn't necessarily mean poor value and there may be many facilities savers benefit from which aren't quantified in the VFM framework (e.g. availability of modellers, websites, helpdesks, guidance, apps, financial wellbeing, open banking).

We agree in principle with the additional consideration of economies of scale as there's a proven benefit. However, bigger schemes don't always provide better value and there may be small or medium-sized schemes who are paternalistic and look after their savers. The messaging should be appropriately managed and the framework should allow for a qualitative overlay.

Question 17: Do you agree with a 'three categories' / RAG rating approach for the result of the VFM assessment?

While we agree RAG ratings are simple and clear we should keep in mind with a future aspiration to communicate VFM with savers, the RAG rating approach may not suit this audience. RAG ratings are often associated with risk ratings, whereas savers often see scales such as 1-5 stars as communicating levels of quality and value. A broader rating scale would also negate the narrow capabilities of a RAG rating.

We agree a VFM (Green) rating shouldn't imply VFM can't be improved further. While the proposals are clear in terms of the RAG approach, the underlying metrics aren't (see the Question 11 response). This could lead to schemes being unfairly given a red rating. An approach identifying an acceptable level of compliance, with a rating above red noting there's more to be done to reach the expected standard, and a level above green indicating the expected standard has been exceeded, may work better than a RAG status.

For simplicity, we've generally continued to reference the RAG rating throughout responses to this documentation rather than including reference to an alternative rating scale.

Question 18: How should we take into account the specific challenges of contract-based schemes while ensuring equivalent outcomes for pension savers?

Legislative provisions to allow providers to transfer savers to another arrangement or provider without consent, would be welcome and will bring contract-based schemes in line with the DWP's bulk transfer guidance for trust-based schemes. The requirement to ask consent of all savers is a challenge which may hinder consolidation, and we would welcome a legislative framework to enable this.

The ability to make specific changes without saver consent varies by provider, as some have prescriptive rules. Any legislative provisions should consider this and whether the legislation can override existing rules providers have in place.

Question 19: Do you agree with our proposals on next steps to take following VFM assessment results, including on communications?

The proposed actions following VFM assessments and the need for justification of VFM are necessary, with the caveat the VFM framework considers a more outcomes-based approach focusing on value and qualitative measures. For instance, a low proportion of savers changing their target retirement age shouldn't in isolation determine a poor Communications VFM, which may trigger a wind-up. In addition, there should be clarity in the assessment which doesn't allow schemes with an Amber rating to go Green for one year, then go back to Amber solely to avoid missing the VFM standard for two successive years.

Communicating VFM is important and we agree employers should be informed of the results to encourage transparency and dialogue. Many employers which have their own governance committees, would already be informed of the individual elements of the framework through regular monitoring. However, other less disengaged employers would benefit from seeing the results .

Communicating with savers is more delicate and so far, communications designed to be addressed to savers such as the Chair's Statement don't necessarily benefit them. Many schemes already communicate their VFM assessment results to savers via newsletters and other communications, so it would be helpful to see more guidance on what trustees, IGCs and providers should communicate to their savers. We welcome more direction to savers on the purpose of such a communication, and the focus to be on the actions being taken by the governing body to improve saver outcomes and awareness. The Pensions Quality Mark is relevant here, as it showcases the value provided and it can be recognised more widely. Any evidence or direction on communication to improve saver engagement and in turn, driving administration responsibility and resourcing would be appreciated.

Q20: If the Chair's Statement was split into two separate documents, what information do you think would be beneficial in a member-facing document?

We acknowledge there's already a broad industry agreement the Chair's Statement doesn't fulfil its original objective as a method by which to communicate with savers.

Savers need to understand information which is relevant and in context. We must consider what information savers value and the types of questions they would ask such as - Is my money safe? Has the fee I pay changed? Do I need to take any action? Consideration should be given to information useful to savers making informed decisions, which guides positive actions and generally provides confidence in pension systems and their scheme.

We encourage more visual examples and simplified text, documents with reliance on figures and percentages could disengage and perpetuate the image of a complex and difficult to manage pension system.

Q21: Is there any duplication between the VFM framework proposals and current Chair's Statement disclosure requirements?

There's duplication with the charges disclosed and some of the investment metrics outlined in Chairs Statement, although we acknowledge this is more quantitative in the VFM proposal and less subjective than the current commentary shown in the Chair's Statement.

We'd be supportive of consideration being given to all compliance and regulatory documentation required to demonstrate value and quality to the various audiences (savers, employers, industry evaluators and regulators) to ensure schemes aren't subjected to overly burdensome regulation.

Q23: Do you think there would be merit in a proposal to mandate the inclusion of a pension saver-focused summary alongside the IGC Chair's Report?

There's limited evidence of employees or employers engaging with the Annual Chair's report produced by IGCs. It's possible future VFM initiatives may lead to greater engagement from employers and initiatives such as Pension Dashboard will generate more engagement with pensions from employees/ savers.

It would make sense to have a report which provides sufficiently granular analysis and commentary to be meaningful to employers and a more intuitive report explaining what a pension scheme/provider does, how they can create value for savers and how the IGC feels their product provider is doing in this regard.

By making these reports pro-actively available to those audiences, a reduced reactive effort will be required in responding to a potentially rising number of requests.

Q24: Do you think the provider or the IGC should be responsible under FCA rules for the publication of framework data?

Insurance company boards, like master trust boards and trustee boards are responsible for the design, management and performance of the scheme(s) which they operate and oversee. For reasons of consistency, insurance company boards should be responsible for the publication of framework data.

IGCs were established to capture the views of savers and act as their independent and expert champion. The role of the IGC is to challenge the insurance company board as the scheme operator to raise its game over time and the independent role could become confused if they're given administrative responsibilities for elements of scheme governance.

Q25: Which of these metrics do you not currently produce? (This could be for either internal reports or published data). Do you envisage any problems in producing these metrics?

PASA doesn't produce these metrics but is a membership association representing our members interests.

It's common for service levels to be captured in relation to transactions, including transactions between administrators and employers, and also between administrators and savers. However, the metrics measured can vary from one scheme or provider to another and the way in which metrics are measured can vary significantly – for example, sometimes the elapsed time for completion of a task is measured by 'stopping the clock' when the next step in a process requires an external response, others keep the clock running.

A project undertaken by the IGCs overseeing Contract Based Provider, to assess VFM across a range of providers found comparing service transactions could only be done at this point on an 'apples v oranges' basis.

The number of savers who make changes to retirement age, or who complete nomination of beneficiary information are not generally captured and recorded. This could more easily be captured in the future where schemes or providers are engaging with savers on a digital basis. In the meantime, instructions received through a range of channels; mail, e-mail, telephone and digital would need to be collated.

Q27: Are you able to quantify these costs at this stage? Are there additional cost components we have not considered? Do you expect these costs to be significantly different for commercial providers and multi-employer schemes?

It's too early to meaningfully cost either the implementation costs or the ongoing operating costs.

We expect implementation costs will include:

- changes to financial reporting to unbundle investment costs from administration costs
- changes to investment reporting including performance comparison against new benchmarks
- changes to service level reporting to make the reporting of transaction services consistent
- development of new service level reporting to capture saver behaviours
- costs to host the information and make this available to industry professionals (phase 1) and savers (phase 2)

Q28: Overall, do you think the benefits of the framework outweigh the costs? Are you able to quantify any of the potential benefits?

We've focused on the administrative elements of the consultation and from this perspective, a framework which attempts to create a meaningful comparison of mono-charge, duel-charge and multi-charge (legacy) schemes/products will prove incredibly complex and costly to implement and operate.

A system which allows schemes with a similar charge structure to compare value against other schemes/products with a similar charge structure (including across occupational DC, master trust, and contract based) would involve significantly less effort to operate.

Q29: Are there additional benefits we have not identified?

None identified.

Q30: Do you have any comments on the positive and negative impacts of these proposals on any protected groups, and how any negative effects could be mitigated?

Vulnerable savers must be considered when creating a framework and considering what information is required. There's a wider issue within the pensions industry of the vulnerability which stems from savers lacking understanding of the pensions system. Consideration should be given to the possibility of indirectly encouraging negative actions - for example savers transferring from schemes more frequently incurring costs which become difficult to measure, against the positives of moving to a higher rated scheme.

Pension scamming should also be considered to ensure ratings aren't used by advisors to encourage transfers simply for the purpose of generating fees.

PASA

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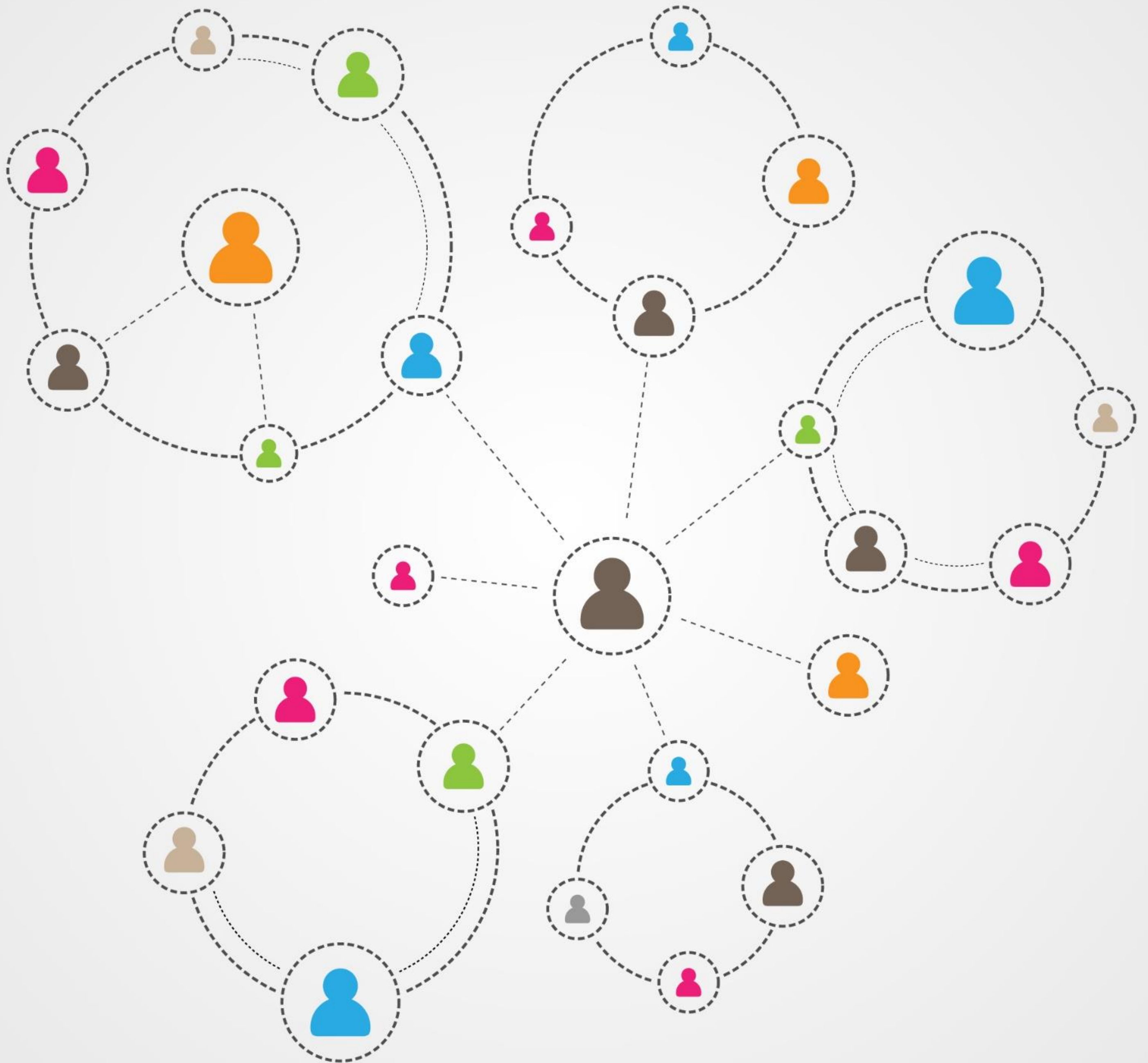

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