

Telephone: 020 7066 9346

Email: enquiries@fs-cp.org.uk

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By email: VFMdiscussionpaper@fca.org.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to the FCA and TPR's joint Discussion Paper (FCA DP21/3): Driving Value for Money in Defined Contribution Pensions

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK.

The Panel welcomes the opportunity to respond to the TPR and FCA's joint initiative to ensure that pension schemes deliver value for money (VFM) to their members. This is a topic of great importance to the Panel, and has been for some time.

The Panel welcomes the fact that the FCA and TPR are considering a requirement to provide information on age-based cohorts. As noted in the Panel's response to earlier consultations on this subject, the needs of specific groups of members may be very different e.g. those in accumulation compared to those approaching retirement.

The Panel is pleased to see cooperation between regulators, including the emphasis on achieving consistency with the approach taken by the DWP elsewhere in the market. The emphasis on ensuring a consistent approach by Trustees and Independent Governance Committees (IGCs) to assessing VFM, by focusing on investment performance, quality of service, and costs and charges, should boost competition and ultimately drive up standards, creating much better outcomes for consumers. It is also important that any measures used are effective, which ultimately will be an empirical question.

The Panel recognises the importance of net returns for member benefits and therefore supports the idea of including net returns in the information that schemes are required to publish. In addition to net returns, the Panel also considers that it would be helpful for information to be provided on risk-adjusted returns. However, it will be important that the approach to risk adjustment is both consistent across the market and effective at measuring the on-going riskiness of the scheme.

In responding to this consultation, we note that a balance must be struck between giving enough prescription to ensure consistent outcomes and embracing an outcomes-based approach, allowing some level of flexibility to achieve the best outcomes for scheme members. Options such as using a neutral convenor to develop service metric standards have potential merit, but only if there is a clear mechanism for ensuring that these standards will be adopted once they have been set. What will be most important, in any case, is an assertive approach to supervision against the desired outcomes. Our response makes reference to the Pension Policy Institutes¹ recent report, where their findings support our responses.

¹ <https://www.pensionspolicyinstitute.org.uk/media/3943/20211118-ppi-value-for-money-final.pdf>

Our responses to the questions posed in the consultation are included at Annex A below.

Yours sincerely,

Wanda Goldwag

Chair, Financial Services Consumer Panel

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

Yes.

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

Yes.

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.

The Panel considers that the benefits from comparing net investment returns will be maximised for multi-employer schemes, if schemes must disclose each different level of net investment performance. This will provide more information than a simple range. For example, it would illustrate whether there are big gaps between the net investment performance seen by your scheme, compared to the experience of other employers within the same multi-employer scheme.

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

Yes. This will increase comparability across the market for pensions.

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?

Given the existence of alternative glide paths for those approaching retirement, the Panel agrees that it would be helpful to have performance metrics that reflect the experience of different age cohorts.

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?

The choice of how to present age cohort specific data may in part depend on who sees the disclosure. If the disclosure will be seen by individual savers, then using DWP style reporting requirements, which shows age specific results for savers aged 25, 45 and 55 may be more meaningful. It would also increase comparability with disclosure in the wider market.

However, if the disclosure is aimed at Trustees and Independent Governance Committees, then it may be more meaningful to have disclosure in terms of years to target retirement in the way that is proposed in paragraph 20 of this Discussion Paper, namely 0 to 5 years, 5 to 20 years or more than 20 years. This is because, if schemes have different rules about when members can retire, it is more meaningful to compare net performance relative to the expected retirement date, rather than at specific ages.

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

If the scheme allows for self-selection then the Panel considers that two separate disclosures would be helpful. The first would be to the individual making the selection, in order to inform their choice. The second would be to Trustees and Independent

Governance Committees, in order to allow them to assess the efficacy of the options on offer through the scheme that they are responsible for.

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?

The Panel considers that providing risk-adjusted returns would be helpful, providing the methodology used to calculate risk was the same for all options, in order to ensure comparability. Therefore it considers that it would be helpful if the FCA and TPR mandated a single methodology, rather than leaving it to individual market participants to decide.

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?

The Panel considers that the choice of risk metric will be important. In particular, it will be important that the risk metric chosen provides a measure that is capable of predicting risk levels in future periods. In other words, the risk metric calculated today needs to be good at predicting what the risk level tomorrow will be when calculated using the same methodology. This will help ensure that risk-adjusted disclosure measures will provide more information about potential future outcomes than would be the case if the risk measures used are very volatile. What will be important in judging risk-adjusted returns is how these compare for the typical risk levels seen by the scheme, not as a result of idiosyncratic market outcomes. This will be particularly important, if the aim is to support long-term saver outcomes.

The Panel notes that analysis² done by Professor Andrew Clare for the Association of British Insurers and Investment Management Association in 2010 comparing different risk metrics found that measures such as the Sharpe ratio and Sortino ratio performed poorly in this regard, producing very low correlations over the sample period.

In order to decide on the appropriate risk-adjustment methodology, the Panel considers that it would be helpful to undertake testing of potential options to understand how informative they are over time. Such testing should include assessing the impact of different requirements for the time span of data used.

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?

No comment.

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

The Panel recognises that there is value in consistency to ensure comparability. However, it is also important to provide data using effective measures, as the consistent use of a poor metrics would not achieve the desired outcomes, even though it would allow for comparability.

The Panel does not have a strong view on what the optimal measure for presenting returns would be. However, it notes that how well different measures perform is ultimately an empirical question. The Panel therefore considers that it would be helpful to test potential alternatives before deciding on the chosen option.

² https://www.bayes.city.ac.uk/_data/assets/pdf_file/0017/32525/risk-rating-comp.pdf

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?

The Panel considers that the potential value of providing more and better data is that it will allow Trustees and Independent Governance Committees to assess how their scheme compares to alternatives. While the Panel does not have a preferred approach that it would like to advocate, it considers that it would be helpful for the FCA and TPR to test alternative approaches to understand how they might drive behaviour and then use this information to help inform their decision-making on how they would like to see this market function.

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

No comment.

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

Yes.

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

Yes.

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

Yes.

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

No comment.

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

Like the FCA and TPR, the Panel recognises the important role that scheme administration plays in creating VFM. Scheme administration can have an important impact on the experiences of savers. As noted in the Discussion Paper, both the TPR and FCA already help set standards through their rulebooks.

Given this, the Panel is concerned that the FCA and TPR are effectively proposing to step back from setting standards for this important area. The Panel considers that this is only appropriate, if there is both a clearly identified body who will take responsibility for setting standards, as well as a clear route to ensure these standards are adopted.

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?

The Panel does not object to the appointment of a neutral convenor to develop service standards, providing this decision also ensures that:

- The person or body appointed is sufficiently knowledgeable of the issues faced within the pensions sector, and importantly their impact on individual consumers, that they will be able to set effective standards; and

- There is a route to ensure that these standards will be adopted, once they have been set.

If this is not the case, then the Panel considers that the FCA and TPR should instead take the lead.

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?

As previously stated, the Panel considers that service standards are important. Having schemes certified against a standard, and using this as part of a benchmarking exercise has potential benefits.

However, the Panel is concerned that the time frame associated with ensuring schemes reach required standards is undefined, which will limit the incentives of schemes to apply any new standards. The Panel therefore calls on the FCA and TPR to ensure they set a deadline for this that is feasible but also allows for a minimal implementation period to ensure consistency.

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

Yes. The Panel considers that this will potentially foster greater comparability across the entire pensions market, allowing schemes to learn from the experiences of schemes with different approaches.

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

In addition to existing measures, the Panel supports the suggestion that it would also be valuable to split the administrative charge into a fund management and pensions administration component. The Panel considers that this will help Trustees and Independent Governance Committees to assess how their scheme compares to alternatives and use this information to drive VFM.

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

Yes. The Panel considers that the introduction of benchmarking will help the market understand how different schemes compare. It will allow Trustees and Independent Governance Committees to assess how their scheme compares to alternatives. It will allow them to use factual information to drive VFM and to underpin decision making, if they realise that savers in their schemes would be better off under a different approach.

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

The Panel considers that using a not-for-profit comparator as a benchmark has merit. It also considers that providing more information than simply a median or mean figure, such as percentiles, would be helpful.