Cosmo Gibson
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

FCA
Practitioner Panel

9 December 2021

Dear Cosmo,

Practitioner Panel Response to DP21/3: Driving Value for Money in Defined Contribution Pensions[1]

The Practitioner Panel is pleased to respond to the Discussion Paper as the question of value for money is an important one across the pensions landscape.

Service vs outcomes

Value for money is the combination of costs and quality. The focus on customer service and oversight as a contributor to the quality of a scheme is very welcome (and backs up all of our experience). But the view of the Panel, and one which it has frequently shared with the FCA, is that this should be wider than just service and instead about client outcomes. We would expect to see more consideration concerning the behaviour of clients, the key planning decisions (e.g. have they set up a nominated beneficiary?) and the understanding of what drives the "good" decision-making.

New Consumer Duty

It is a significant concern of the Panel that there is no mention in the Discussion Paper of the new consumer duty. This suggests that things are not joined up. The Duty has been laid out as a means to get firms to drive better client outcomes for the demographic/groups that they are aiming to help. There is a risk here of multiple overlapping regulations that might not actually lead to the same actions from firms or outcomes for consumers. The subject matter must cross tPR and FCA regulated schemes, but there will be learnings from the consumer duty work that can and should be adopted. In particular this would lead to better outcomes than using universal consumer service metrics such as BSI.

Costs and charges

The Discussion Paper proposes looking at value for money through three lenses; investment performance, customer service/scheme oversight and costs and charges. It is important to consider how these are addressed: comparing investment performance net of fees as one strand and costs and charges as another essentially leads to double counting of costs and charges. A more appropriate and user-friendly approach would be to have investment performance net of investment fees (but excluding admin and service) as one lens with costs and charges of the administration and service (e.g. platform fees) as another.

Shaping the data reporting

Transparency of data in reporting has been successful in driving many changes in this space, but it is also important to have a view of any behavioural change it is hoped that this will drive. It is not clear who the data will be designed to be distributed to and how it would be used. The Panel recommends thinking this through in detail as it will shape the data requested.

[1] https://www.fca.org.uk/publications/discussion-papers/dp21-3-driving-value-money-defined-contribution-pensions

Comparing across the industry

It is critical that there is clarity on the intended audience of a common value for money framework. It would be challenging to produce metrics that will be of value to regulators, IGCs/Master-Trust and Trustees/EBCs which can also be understood by consumers. It is sensible to base value for money comparisons on cohorts of similar customers, rather than at individual employer level. Analysis based on individual employers will be unmanageable for IGCs, for example, Aviva's IGC alone provide pensions to over 29,000 employers.

Benchmarking

Benchmarking costs across the pension landscape is incredibly challenging due to the fact that some providers don't compete for consumers (e.g. NEST) - there are differing business models and therefore costs of acquisition.

It wouldn't be appropriate to introduce a single benchmark for costs and charges for the following reasons:

- This can potentially drive customers to the 'cheapest' (not necessarily the best or most appropriate product).
- The value of the different features of a product which might be more expensive for good reasons, may not be fully understood by customers, for example, a pension fund with lifestyling, guarantees, telephone servicing, full retirement flexibility.
- This could stifle innovation as it may result in firms adopting a similar approach to mitigate the commercial risk of underperforming against that benchmark, particularly if the benchmark is seen to be endorsed by government and/or the regulator.
- Effectively there is already a "benchmark" for costs and charges in Workplace schemes - 0.75% is the maximum charge for auto-enrolled members, and the DP already accepts that the average is considerably lower. For non-AE workplace schemes, legacy schemes will be outside this cap and there is an unwritten acceptance from legacy provider IGCs that 1% is within tolerance. In practice, an employer can be charged 0.5% in a new workplace scheme but it is a matter of what their employees receive for that fee in terms of service, communications, engagement tools and investment performance, versus what they get for 1% in another scheme.

Benchmarking for performance

The Panel does not agree that benchmarks for performance are useful for similar reasons to benchmarks for costs and charges (see above). Aviva, for example, operates two core default funds in Workplace, My Future and My Future Focus, the former outperformed the latter last year but the IGC continues to endorse My Future Focus as a better long term investment default due to its diversified asset mix.

Customer service metrics

In relation to developing accreditation and certification or a single method of measuring and reporting customer service:

- Regulatory intervention would be needed as no single firm has sufficient market influence to make this mandatory. Unless it is a regulatory requirement, firms are unlikely to make the necessary investment.
- Any measure for service should be on the quality of that service. For example, if one firm is responding to customers within two days but has a 30% error rate, that is a

worse customer experience than another firm who responds to customers within five days with a 100% QA score. Any metrics need to look at promptness and accuracy of administration as well as the quality of the member engagement tools and communications.

Interacting with other rules

There is a significant difference between default pension options and self-select options. It is not clear what the case is to extend this framework more widely to self-select options where other regulatory protections exist. However, any new rules for workplace products should align to existing DWP statutory guidance on value for money comparisons.

Additional issues specific to legacy products

Overall, the proposed value for money framework focuses on modern workplace pensions, however, more detailed consideration of the valuable features of legacy is needed, for example:

- Life cover, access to Premium Waiver and offline servicing. There should be a consistent approach for measuring value for money however, there needs to be a way of valuing older features in legacy compared to what is available in the market now, so that this can be considered by an IGC.
- It can be challenging for an adviser to advise trustees or customers to transfer out of an older scheme to a new one as there is often value in older features that are no longer offered in new schemes. This indicates that old schemes can offer better value overall compared to modern alternatives in the market. Accessing accurate information and appropriate valuation of product features compared to alternative comparators will be extremely challenging, for example valuing a Premium Waiver benefit or a guarantee that a customer's fund will not go down in value compared to lower charges, the opportunity for higher annual returns (albeit with some risk) and better communications.
- When comparing performance across cohorts any new rules should allow firms to be able to separate legacy from modern products as there is significantly more variety in the charging structures of legacy products.
- FCA propose assessing performance net. The regulators need to clarify whether this will require assessment based on a representative range of members within a cohort, to enable meaningful comparisons given the differences in charging structure for legacy products.
- Many legacy products have structures where charges change over time (for example loyalty bonuses) so it is essential that firms are permitted to take a forward looking view to include these in comparisons.
- Any measure of charges should be allowed to take into account future changes to charges. The Discussion Paper suggests comparing retrospectively not prospectively. However, product (a) may be cheaper than product (b) over the next few years, but product (b) is cheaper over longer periods. For example, the AMC could be 0.75% now but reducing to 0.35% in a couple of years and so the impact very much depends on the remaining term.
- Some charges within legacy products are paid for outside of the product unlike many modern products (for example commission). Any new rules should allow firms to show this in comparisons to ensure that we're comparing like with like. For example, product (a) could have an AMC of 1.25% and 0.5% trail commission paid for within the product. Product (b) could have an AMC of 0.75% and 0.5% trail commission paid for outside of the product. The total charges paid by the customer are the same, but the charges on product (a) will appear 0.5% higher than those on product (b).

- Comparison of investment returns should be wider than just default funds since legacy (and individual pensions) typically do not have these. The new rules should allow comparisons to include pre-determined investment portfolios and balanced/managed type funds where there are no default funds.

We would be happy to discuss any of these points in more detail.

Yours faithfully,

Paul Feeney
Chair, FCA Practitioner Panel