Sackers

FCA consults on the new value for money framework

Alert | 08 August 2024

Introduction

Building on its work in tandem with the DWP and TPR, the FCA today published a consultation on detailed rules and guidance for a new value for money ("VFM") framework.

Key points

- Today's consultation represents the culmination of work by the FCA, the DWP and TPR towards a new market-wide VFM framework for DC schemes ("Framework"). Once implemented, all schemes in scope will be required to report on wider value metrics and to use this data to assess the value of their offering against real market comparators.
- The consultation sets out the proposed rules and guidance that will apply to default arrangements of FCA-regulated workplace DC schemes, but with metrics and concepts intended to be suitable for application across the whole DC pensions space. This includes a new traffic light ratings system.
- TPR is urging trustees to respond to the "technical detail of the consultation, with a view to ensuring the final framework can be applied effectively to trust-based schemes". Similarly, the FCA plans to continue to develop its approach to implementation in light of VFM changes to be included in the Pension Schemes Bill.
- The current "value for members" assessment that must be carried out by trust-based DC or hybrid schemes with less than £100 million in total assets is expected to be phased out as the new Framework is introduced.

Background

Over the last few years, the DWP, TPR and the FCA have been working together to establish a common assessment framework for VFM intended to encourage greater transparency and standardisation of reporting. This resulted in a January 2023 consultation on policy proposals to require trustees and managers of DC occupational pension schemes, as well as the providers and IGCs of workplace personal pension schemes, to disclose, assess and compare the VFM of their schemes.

Published as part of last July's Mansion House proposals, the consultation response confirmed the parties' intentions to press ahead with those changes. Further consultations on draft regulations and FCA rules to pin down the detail have therefore been expected for some time.

Requirements for trust-based schemes will be included in the new Pension Schemes Bill, with the FCA responsible for ensuring the Framework is applied to contract-based arrangements. The new Government's ultimate aim is that the new VFM requirements will result in further consolidation in the pensions market by leaving a smaller number of well-performing, well-governed schemes which will "improve outcomes for savers" and "lead to more productive investment of funds".

The FCA's proposals

The FCA's consultation sets out its proposed detailed rules and guidance that will apply in relation to default arrangements of workplace DC schemes.

Key outcomes

In the context of the "complex and growing" pensions industry, the proposed measures aim to:

- reduce the number of savers with workplace personal pensions that are delivering poor value, and
- drive better VFM across the workplace DC market through greater scrutiny and competition on long-term value rather than predominantly cost.

The new requirements will sit within and expand upon FCA-regulated firms' existing consumer duty processes, which already oblige firms to consider the value of the pensions products they offer.

Headline proposals

Four main elements are proposed:

- requiring the "consistent measurement and public disclosure of investment performance, costs and service quality" against metrics which the FCA believes will allow VFM to be assessed effectively
- enabling those "overseeing and challenging an arrangement's value" (ie IGCs and GAAs for contract-based schemes, or trustees of trust-based schemes) to assess performance against other arrangements and requiring them to do so on a "consistent and objective" basis
- requiring public disclosure of assessment outcomes including a "red", "amber", or "green" VFM rating for each arrangement, and
- requiring firms to take specified actions where an arrangement has been assessed as "not VFM" (ie it has received an amber or red rating). Those running pension schemes will be expected to "address poor performance and improve genuine long-term value".

Issues being consulted on include the range of actions to be taken by firms in the event an arrangement is not VFM, the annual publication cycle and the details of how metrics are to be published. Given the "significant debate about how to foster a better investment ecosystem in the UK", the FCA is also proposing greater disclosure about the types of assets that contract-based schemes are investing in, as well as measures to enable greater transparency on "geographic asset location".

Feedback is welcomed from across the pensions industry, including trustees and sponsors of trust-based schemes, as well as firms operating contract-based workplace pensions, IGCs and GAAs.

Measuring success

An amber rating will indicate that an arrangement "can be improved within a reasonable period of time such that it offers VFM". A red rating is intended to mean that "it cannot or will not be improved within a reasonable period of time". The new Framework is expected to result in initial steps to address poor value in amber or red-rated arrangements, ultimately leading to "less of a gap between worse performing arrangements and the market average".

In the short term, measures to evaluate its impact might include data on employers switching arrangements or better negotiated terms. But the consultation paper acknowledges that, as DC pension products are long-term investments, value "will only become apparent over the longer term". Further work is therefore needed, alongside the DWP and TPR, to develop the FCA's approach to measuring success.

Possible future developments

As part of the consultation, the FCA asks some "explorative questions" seeking views on how the use of VFM data might evolve, and potential future enhancements to the Framework. This could include creating third-party "league tables" to help compare performance. While this could promote stronger competition, the FCA cautions that it could also result in unintended consequences, such as a focus on particular metrics and a neglect of other value measures. As such, "careful consideration" would need to be given to the design of any benchmarks or similar measures to avoid incentivising inappropriate short-term actions and "clustering", as well as limiting innovation.

Looking further ahead, the FCA suggests it could explore with the DWP "the impact of incorporating some VFM information, including on member comprehension and behaviour" into pensions dashboards. Also, the Framework could potentially be adapted to apply to non-workplace pensions and decumulation solutions.

Next steps

With the consultation closing on 17 October 2024, the FCA plans to publish a final policy statement, rules and guidance "in due course". Timings for implementing the Framework will be considered "following stakeholder feedback" and in discussion with the DWP, HMT and TPR.

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