Consultation Questions: Consultation on Value for Money: A framework on metrics, standards and disclosures

Name of respondent/s / organisation (please provide):

Pensions Policy Institute (PPI)

Pension Scheme type(s) (please cross all those that apply)	
Master Trust (500 or more employers approx.)	
Master Trust (fewer than 500 employers)	
Single-employer trust-based defined contribution (DC) workplace pension scheme	
Contract-based DC workplace pension scheme (500 or more employers approx.)	
Contract-based DC workplace pension scheme (fewer than 500 employers)	
Contract-based DC non workplace pensions	
Defined benefit pension scheme	
Hybrid pension scheme	
Your role (please cross all those that apply)	
DC pension scheme trustee or manager	
Member of Independent Governance Committee (IGC) or Governance Advisory Arrangement (GAA)	
Administrator	
Investment consultant	
Financial advisor	
Employer	
Employee benefit consultant	
Consumer organisation	
Law firm	
Pension saver	
Other (please state)	Researcher, Independent Research Institute

Responses to consultation questions are optional. We ask that you provide your reasoning for your answers to the consultation questions that you respond to.

*Please indicate, next to any responses given, if you are **not** content for DWP to publish relevant sections of your responses in the future. Without a specific request for anonymity, we reserve the right to publish your response in full.*

PPI response to the Department for Work and Pensions', the Financial Conduct Authority's and the Pension Regulator's consultation - Value for Money: A framework on metrics, standards, and disclosures

Response from the Pensions Policy Institute, March 2023

1. This is the Pensions Policy Institute's (PPI) response to the DWP, FCA and TPR's consultation on a Value for Money Framework (VFM).

2. The PPI promotes the study of pensions and other provision for retirement and old age. The PPI is unique as it is independent (no political bias or vested interest), focused and expert in the field, and takes a long-term perspective across all elements of the pensions system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.

3. This submission does not address all consultation paper questions. Rather, the response takes the form of summarising relevant conclusions of several PPI reports:

   - 2023: **What role could alternative assets play in DC investment strategies in the future?**[1];
   - 2022: **How will future pensioners use guaranteed income products?**[2];
   - 2022: **Could DC pension default investment strategies better meet the needs of members?**[3];
   - 2021: **What is the impact on member outcomes of different non-capped charging structures?**[4];
   - 2021**: What can other countries teach the UK about measuring Value for Money in pension schemes?**[5]

   This covering letter sets out the main conclusions of these research reports as they relate to Value for Money. Please read the reports for the underlying analysis.

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[1] https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2023/2023-03-09-what-role-could-alternative-assets-play-in-dc-investment-strategies-in-the-future/

[2] www.pensionspolicyinstitute.org.uk/media/4151/20220908-how-will-future-pensioners-use-guaranteed-income-products-final.pdf

[3] www.pensionspolicyinstitute.org.uk/media/4018/20220202-ppi-dc-default-pension-investment-strategies-report.pdf

[4] www.pensionspolicyinstitute.org.uk/media/3952/20211124-ppi-what-is-the-impact-on-member-outcomes-of-different-non-capped-charging-structures.pdf

[5] www.pensionspolicyinstitute.org.uk/media/3943/20211118-ppi-value-for-money-final.pdf

4. We would be happy to discuss the contents further if that would help the consultation.

Relevant conclusions from: "What role could alternative assets play in DC investment strategies in the future?"

5. There are low levels of alternative asset investment by Defined Contribution (DC) schemes partly because the last decade has focused on the implementation of automatic enrolment and building scale. However, schemes appear increasingly focused on evolving and improving investment strategies, building quality, incorporating sustainability objectives and demonstrating Value for Money. An increased focus on reporting and transparency is likely to drive further change. The DC market has been shaped by a focus on charges and competition, but the Department for Work and Pensions (DWP) and regulators are working to shift this focus towards value for members.
6. Charging structures and considerations around cost may act as a barrier, whether real or perceived, to greater investment in alternatives and particularly illiquids. Investing in illiquid assets tends to be more expensive and these investments may take some time to generate returns. Performance fees continue to be a challenge, in terms of price competitivity, inaccessibility for smaller schemes, and potential for unfair sharing among members when there is a time lag on levying the fees.

Relevant conclusions from "How will future pensioners use guaranteed income products?"

7. Future pensioners will be more dependent on their DC savings, as they will be less likely to have a Defined Benefit (DB) safety net to fall back on. Decisions about how to access DC will more significantly impact retirement experiences and running out of DC savings too early in retirement could cause serious financial difficulties. Pensioners will face increased levels of financial risk, which extend from at-retirement decision making into mid and late retirement, and many will not have the financial capability to make informed decisions without support.
8. Both working and retiring has become more flexible. Working lives are becoming increasingly heterogeneous as levels of casual and self-employment increase, and people move in and out of the labour market more frequently. Alongside changes in working patterns, retirement is also changing as people find they need to work longer to provide for themselves and/or prefer a more gradual move into retirement through part-time/flexible working than a cliff edge. This means that income will need to be taken in increasingly flexible ways, to help people with saving for retirement going through retirement transitions and into retirement.
9. Engagement, communications and guidance for those in the saving phase will need to be designed to help people prepare for their future retirement needs if pension savings are to provide value for members which fits with members' own needs and desires.

Relevant conclusions from "Could DC pension default investment strategies better meet the needs of members?"

10. Membership of DC default investment strategies has increased as automatic enrolment has brought more than 10 million people into pension savings, most of whom have remained in their schemes' default investment strategy; 90% of those enrolled in master trust/multi-employer schemes are in the default investment strategy.
11. Finding the appropriate balance between two contrasting goals, higher returns and lower risk, is a key challenge when setting the high-level asset allocation strategy of default investment strategies. Since a default investment strategy applies to a wide cross-section of scheme members, it cannot be tailored to each member's individual circumstances and preferences. Rather, the best possible fit must be found to meet a diverse range of needs. This means that, for members who do not fit the typical or representative profile on which the default investment strategy is based, better solutions may exist. In broad terms, those solutions will involve either (a) more focus on the maximisation of return or (b) more focus on the management of risk.
12. There are several policy options for ensuring that DC default investment strategies meet the needs of a wider range of members:
    A. Increasing asset allocation to alternatives could enhance returns while also increasing diversification, potentially benefiting all members.
    B. Using existing data on members, such as pot size, in order to provide prompts about using non-default (self-select) investment strategies.
    C. Gathering more data on members in order (a) to make DC default investment strategies more tailored or (b) to provide prompts about non-default (self-select) investment strategies.

Relevant conclusions from "What is the impact on member outcomes of different non-capped charging structures?"

13. The average charge in non-qualifying workplace schemes has decreased markedly in recent years, closing the charge gap between qualifying and non-qualifying schemes to 0.05% of assets under management (AUM). The closing of the charging gap is assumed to be, at least in part, the result of competitive pressure exerted from schemes subject to the charge cap. Further pressure has been applied from a level of 1% of AUM a year being taken as a benchmark of Value for Money by Independent Governance Committees (IGCs) where the charge cap does not apply. 14% of assets in legacy schemes still attract charges above 0.75% of AUM.
14. Typical charges in a qualifying scheme erode retirement savings by around 14%. Annual charges in these schemes are around two-thirds of the level of the cap. Charges at the level of the cap, which are more indicative of individual personal pensions, erode retirement savings by around 20%.
15. Providers of schemes designed to accept transfers in and consolidate schemes have a fundamental advantage over providers targeting the automatic enrolment market. While they are out of scope of the charge cap, they should be able to offer more competitive charges as they do not have to support the costs of small pots through cross-subsidisation. This situation is linked to the issue of small, deferred pots which puts charging pressure on providers who target the automatic enrolment market. Such providers end up managing many uneconomic small inactive pots which will not receive contributions to grow to an economically viable size. This pressure has implications for the members who are paying charges which subsidise the uneconomic pots.

16. Flat fees reduce the need for cross-subsidisation from members with larger pots to those with smaller pots. For schemes which have a larger proportion of small, deferred pots the removal of flat fees will place additional pressure on the cross-subsidisation of these pots. This balance is exacerbated when pots which provide the cross-subsidisation are transferred out of the scheme.

Relevant conclusions from "What can other countries teach the UK about measuring Value for Money in pension schemes?"

17. There are a number of key messages from other countries (New Zealand, The Netherlands, Australia, Sweden and the US) that are relevant to UK DC practice and policy:
    - A clear statement of and a consensus around the outcomes sought in assessing VFM are a necessary precondition to effecting positive change in which outcomes are expressed from members' viewpoints as things that they value.
    - By setting clear, measurable and comparative standards and benchmarks for performance in the key areas of delivery – investment, administration, engagement – it is possible to drive a more effective tendering process for these services to secure VFM.
    - Publicly available, consistent, robust and complete comparative data is a vital starting point for authoritative VFM assessments and broader market context. The evidence suggests that this requires a trusted regulatory framework to facilitate.
    - There are barriers to members exercising informed choice and so where choice is provided it is unlikely to lead to good outcomes unless the choices available are carefully designed and edited. Close, active governance will be required to manage this process if good outcomes are to be achieved and maintained.
    - Achieving scale has positive impacts on costs, but diminishing returns will set in. Large funds face new opportunities to achieve diversity in assets through unlisted or direct investments to secure consistent high returns. Evidence suggests that this will increase unit investment costs if these additional returns are to be accessed.
    - Consistently positive real investment returns, within appropriate volatility parameters – both upper and lower – are the most significant driver of VFM in terms of net returns. But outcomes for savers in terms of meeting target income levels are most influenced ultimately by the level of contributions.

18. What could a Value for Money framework look like?
    Using the international research findings from the report, it could be concluded that a VFM framework should include the following elements (figure C1):

    - Investment performance
    - Member engagement
    - Administration
    - Costs and charges

    Overarching these elements is the need for good governance of the system. It is governance that has the power to set, monitor and amend the delivery of the various services to schemes and their members so as to maximise the VFM and consequently the outcomes, in terms of retirement incomes.

Figure C1

A possible international VfM framework

Pensions Policy Institute
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