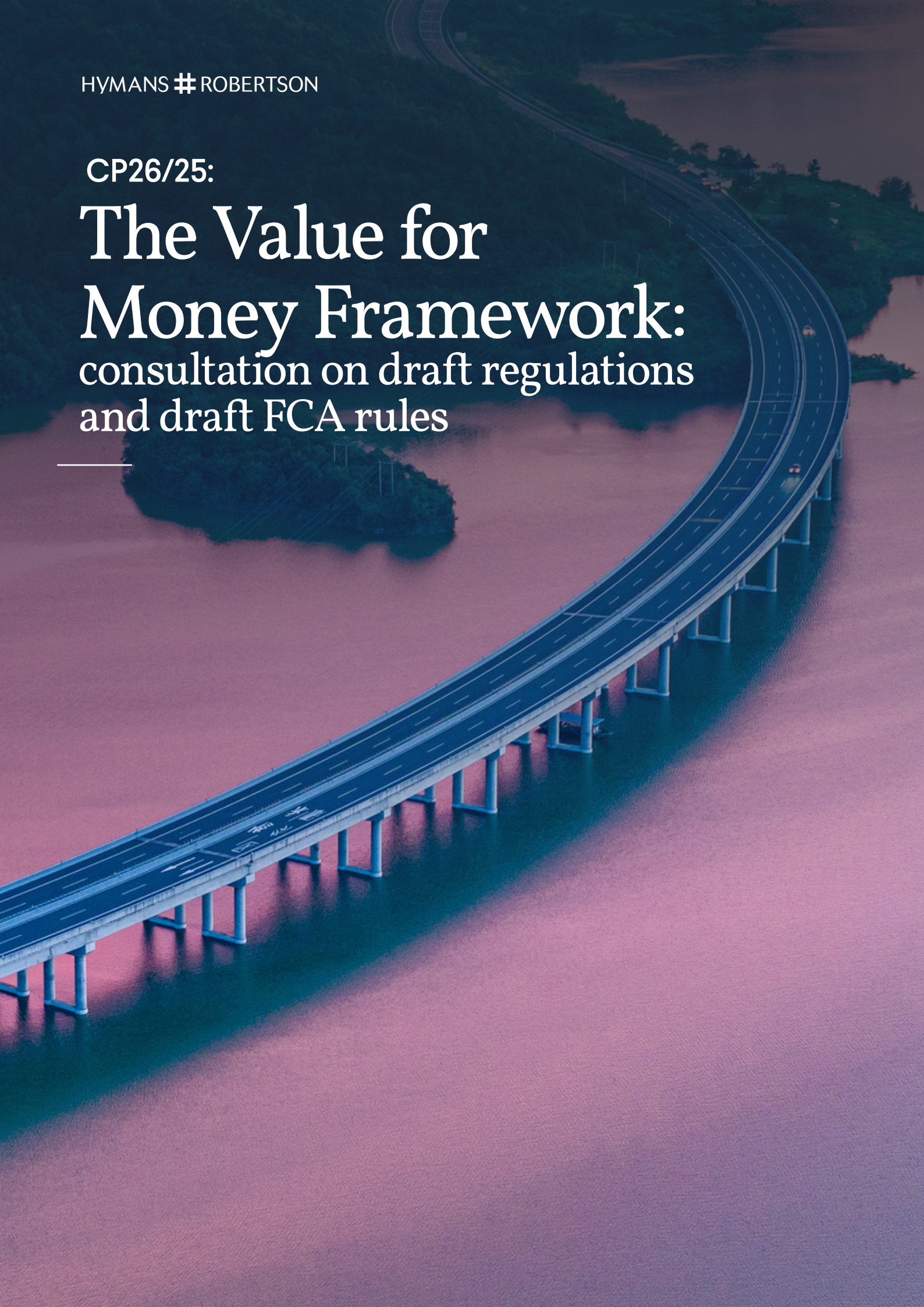


HYMANS # ROBERTSON

CP26/25:

The Value for Money Framework: consultation on draft regulations and draft FCA rules



We're pleased to provide our response to the FCA, the DWP and The Pension Regulator's joint consultation on the Value for Money Framework: consultation on draft regulations and draft FCA rules.

Hymans Robertson is one of the leading advisers to UK DC pension schemes and has always had a focus on delivering good value for money for the schemes we advise. We also advise a range of providers in a variety of areas, so we understand that marketplace well.

We'd be happy to provide further information and backing evidence if this would be helpful as part of the consultation process.

Our role and consent

I'm responding to this consultation as a representative of an organisation (Hymans Robertson LLP). I consent to being publicly named as a respondent to this consultation. I consent to my response being made available to the public.

Please note that we're responding as a pensions consultancy who provide DC consulting services to trust- and contract-based arrangements in our capacity as DC investment consultants and governance advisers. We also provide advice to providers in the DC marketplace. We note that our staff scheme participates in a master trust with fewer than 500 employers, although we're not a master trust.

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Anthony Ellis
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On behalf of Hymans Robertson LLP

Question 1

Do you have any comments on our proposals for phasing?

We support the proposed phased implementation. The Value for Money (VfM) Framework represents a significant change for schemes, providers, advisers and regulators, and the proposed approach provides a sensible opportunity to test data collection, reporting and assessment processes before formal consequences apply. In our view, this will improve the quality and consistency of assessments and reduce the risk of poor outcomes arising from immature processes or incomplete data. While phased implementation means some members may wait longer to benefit from the full Framework, we believe the benefits of a carefully managed introduction outweigh this risk.

Question 2

Do you have any comments on our proposal to limit the first data collection period to six months?

We support the proposal to limit the initial data collection period to six months. Given the scale of change being introduced through the VfM Framework, this strikes an appropriate balance between maintaining momentum and allowing schemes, providers and advisers sufficient time to prepare robust data collection and reporting processes.

In our view, the benefits of improved readiness and data quality outweigh the loss of six months of information. While some metrics, particularly service quality measures, may be more susceptible to short-term fluctuations over a six-month period, we don't believe this outweighs the practical advantages of the proposed approach.

Question 3

Regulatory own funds schemes were included in the 2006 Regulations; is there a continued need for their inclusion within the Regulations?

We feel that AVCs should be subject to at least some of the VfM requirements.

‘In-scheme’ is not defined in the consultation, but we take it to mean: 1) unbundled arrangements using a scheme’s administration and fund managers and 2) bundled arrangements where most services are provided to the scheme under a policy with an AVC/ DC provider.

AVCs often represent a member’s principal form of discretionary savings for their retirement and are a key part of their financial planning at retirement (ie to fund their pension commencement lump sum rather than commute a valuable DB pension). It’s also our experience that many scheme members expect trustees will take good care of their savings.

Moreover, while members will have taken an active decision to save more for their retirement, relatively few make active investment choices. If they do, they rarely revisit investment choices made when they started paying AVCs. As a result, many AVC payers will be in default options (sometimes for legacy policies set by the provider rather than the trustees) or quasi-default options.

Sadly, despite The Pension Regulator (TPR) guidance, these AVC arrangements often use poor value legacy products, with high charges, dated investment options (eg with no consideration given to ESG or climate change factors), and basic levels of administration and communication (eg no online access, making it difficult for members to manage their savings).

TPR recognises that AVC governance should be proportionate, based on how important AVCs are to individual members. While it would be disproportionate to require AVC arrangements to meet the full range of requirements discussed in this consultation, we believe that requiring trustees of DB schemes to undertake a VfM assessment covering key aspects of AVC arrangements would improve benefit outcomes for many members. This could cover charges, the performance and continued suitability of investment options, standards of administration and member communications, and choice of provider every three years, with an annual exceptions check prompting a more detailed review if necessary.

Where a DC scheme is in place, with the primary purpose of being a time-limited feeder scheme for a DB arrangement, we suggest this is another example where the principle of proportionality should be applied, at least in relation to the scale test. At a time where pensions adequacy is being debated, removing a benefit that leads to a DB benefit seems like poor overall value for members.

Question 4

Do you agree with the proposed exemptions (full and partial) for contract-based arrangements where there is a transfer or a plan to transfer? Why or why not?

We agree with the proposed exemptions for arrangements that are in the process of transferring, or where a clear and credible transfer plan is in place. Requiring a full VfM assessment immediately prior to a transfer is unlikely to provide significant additional benefit to members and may result in unnecessary costs and duplication of effort.

However, the exemption should only apply where there's a genuine and well-developed transfer plan with clear implementation timescales. We'd be concerned if the exemption could be used for prolonged periods without meaningful progress towards completion, particularly where members remain invested in arrangements that may not be delivering good value. Regulators should therefore retain oversight of exempt arrangements and require evidence that transfer activity is progressing as expected.

Overall, we believe the proposed approach strikes an appropriate balance between member protection and proportionality.

Question 5

Do you have any further comments on our proposed scope?

We have no further comments.

Question 6

Do you agree with the proposed updated methodology? Do you envisage any issues with calculating investment performance metrics on a basis that tracks members experience over time, while excluding contributions? Please specify where problems might arise, if any.

On the basis that it's geometric and reflects the performance that members receive, we're supportive of the proposed updated methodology, which aligns with industry practice for gathering and reporting information of this kind.

We don't envisage any issues with calculating investment performance metrics in a way that tracks experience and excludes member contributions. This is typically the way reporting is undertaken to trustees and members at present (ie performance is reported on its own merits); we believe it's fairer.

Question 7

Do you agree with the removal of standalone BLM disclosures at 5YTR? Are there any issues associated with its removal?

Yes, given the new calculation of returns, the removal of the five-year cohort is pragmatic. Our only concern is where there are differing glidepath lengths. Taking risk off too early or leaving it on for too long can result in poor member outcomes for those in the de-risking phase of the glidepath. Some measure should be introduced to capture where glidepath design isn't resulting in good member outcomes, and this can't be achieved using only the 30-year and zero-year cohorts.

Question 8

Are you comfortable with ASD as a risk metric for all arrangements, or should some arrangements calculate their volatility metrics differently? Please specify under what circumstances and what modified calculations you would recommend.

We think standard deviation is a poor measure of risk and can lead to the skewing of outcomes. It assumes normally distributed returns and can underestimate real downside risk. It's also easily distorted by outliers and doesn't account for correlation changes in periods of market stress, which is often seen. We prefer max drawdown and length of drawdown as measures of downside risk.

Question 9

Are there any circumstances in which a scheme would not have access to the historical cost information required to apply the same chain linking methodology to costs as done to gross performance figures, noting the more limited scope under which chain-linking is applicable?

For most schemes, we don't anticipate that this would be an issue: we expect providers to be able to grant access to historical cost information, even if consultants don't have it. That being said, we're aware of a small number of schemes (colloquially called 'distressed' DC schemes) taken on by independent professional trustees, where there's a lack of information generally. However, this should not be an issue across the board.

Question 10

Would there be a material reduction in burden if net performance were to be calculated first, and then chain-linking applied to it, rather than chain-linking costs in order to derive accurate net performance metrics?

We don't think there would be a material reduction in burden if net performance were to be calculated first, because the same cost information is still required to derive net performance. It may, however, shift the burden of calculation from consultants and trustees to a provider, but overall, the amount of work would remain the same.

Question 11

Would trustees or firms have the necessary data to retrospectively determine if an arrangement would have been classed as quasi-default up to 10 years prior, so as to apply chain-linking where necessary?

In most cases, we believe well-governed schemes would have the necessary data, or access to the people who could provide it, to determine retrospectively if an arrangement would have been classed as quasi-default. However, there are a small number of schemes with weaker records and governance where this won't apply.

Question 12

Do you agree with the proposed requirements for FLM disclosures and safeguards? Why or why not?

We're supportive of both the proposed forward-looking metrics (FLM) disclosures and the safeguards. However, we're unclear about the practical operation of the safeguards, and how this mechanism would work in terms of the actual publication of information. We question what happens if a scheme's assumptions are significantly higher than its peers', and whether schemes could still appear artificially attractive in VFM disclosures, even where TPR has concerns about the reasonableness of those assumptions.

Question 13

Do you agree with our revised proposals in relation to Asset Allocation? Please provide details of any concerns you have relating to our proposals.

We agree with the revised proposals regarding asset allocation and have no concerns relating to them.

Question 14

Do you have any comments on the definitions used above? In particular, do you have any comments on the definition of 'UK-based entity'? Is there an alternative definition you would suggest?

We don't have any comments.

Question 15

Do you agree with our proposed definitions? In particular, do you agree with our definitions of UK assets? Are there any areas where definitions need to be tightened to ensure consistency of measurement?

We agree with the definitions and have no further comments.

Question 16

Based on the new proposed calculation methodology, we would be interested in views on whether, to help mitigate the risk that there are few – or no – members within the retirement cohorts, it would be more practical to calculate the median based on the number of employers, rather than members.

We agree that calculating the median based on the number of employers is a reasonable approach and a more pragmatic option than the member-based calculation. It also has the advantage of highlighting any higher charges being borne by members affiliated with smaller employers.

Question 17

We would be interested in views on whether all multi-employer arrangements should disclose maximum, minimum and median cost metrics, in order to highlight variations in the treatment of small or large pots.

We support the introduction of this requirement.

Question 18

We would be interested in views on whether member-level calculations (Option A) or the model pot size approach (Option B) would be more effective.

The member-level calculations set out in Option A appear particularly onerous. We'd support a more pragmatic approach, such as Option B.

Question 19

Do you agree with our suggestion that the variable effects of complex charging structures on pots of different sizes should be disclosed separately from the effects of commercial variations of fee terms? Do you agree with our proposal for achieving this?

No, we don't believe separate disclosures would be proportionate, given the likely positive relationship between member pot size and commercial terms, and the additional data and reporting requirements of producing such disclosures.

Question 20

How should the separate pot size effect disclosures be used in the assessment of value? Should they be based on peer-to-peer comparisons (consistent with the rest of the VFM Framework) or should trustees / IGCs carry out value assessment internal to the arrangement, to determine whether the small pot members are excessively disadvantaged compared to their fellow members with larger pots?

We support the use of peer-to-peer comparisons as the primary basis for assessing pot-size effects. This is consistent with the wider architecture of the VFM Framework and supports comparability across arrangements. However, trustees and independent governance committees (IGCs) should also consider whether small-pot members experience materially poorer outcomes than larger-pot members within the same arrangement. Internal comparisons can provide useful context and help identify emerging member outcome risks that may not be evident from peer benchmarking alone.

Question 21

Would it be helpful if we defined STP as a fully automated process for the purposes of VFM and asked schemes to confirm: What percentage of payments fall within this definition? The mean and range of all contributions falling outside this definition?

We believe it would be helpful to have a clear, industry-wide definition of straight-through processing (STP) that all providers can use. There are various methods across the industry for measuring processes; a consistent definition would allow for comparison across providers.

Where some payments will fall within and outside of the definition of STP, we don't believe this statistic is necessarily meaningful. It's challenging to judge whether the percentage of payments within the definition of STP reflects good or bad outcomes, or whether the percentage that falls out of line of the mean/range is good or bad. Regardless of a provider's own methods, processes should be assessed based on one defined approach to STP. Providers can disclose how many of their processes are in line with or outside of the consistent definition.

Question 22

Do you agree that the metrics for trust-based and contract-based complaints processes are now comparable? Are there any further steps that we should take?

We agree that the metrics are now comparable as they're measured on a consistent basis; however, they could be improved – for instance, by taking account of complaint outcomes. Measuring the time taken to deal with complaints doesn't necessarily reflect the quality of the outcome, for example. A complaint could be dealt with quickly, but this doesn't guarantee it was the correct action to take.

Question 23

Are partly upheld Financial Ombudsman decisions recorded as a separate category by firms or included within the upheld figures?

We have no comment on this question.

Question 24

Do you agree with the proposed approach to consider decumulation aims separately for the 0 YTR cohort? Why or why not?

Yes, we support considering decumulation aims separately because retirement strategies with different objectives should be assessed against comparable like-for-like strategies, rather than against fundamentally different approaches.

Question 25

Would decumulation aims be more appropriately considered in step 3 rationalisation?

We think the investment-related elements should be considered in step 1 alongside decumulation aims, which shouldn't be moved to step 3. However, step 3 could be used to highlight exceptional circumstances where a scheme has been unfairly represented in step 1 for investment returns.

Question 26

Do you agree with the decumulation aim sub-categories? Why or why not? Are they sufficiently clear, or do they need to be defined?

We don't agree with the decumulation aim sub-categories – we believe they aren't sufficiently clear. It would be beneficial for the categories to be explained through examples and characteristics, rather than strict definitions that could create loopholes or confusion.

Question 27

The proposed shift in approach for the first year of the Framework moves away from a more granular assessment of value that we have consulted on previously. We welcome feedback on where stakeholders consider there to be concerns in relation to the data sets, the proposals set out in CP26/1 for the publication and use of multi-employer cohorts, and the proposed changes.

We support the proposed simplified approach for the first year of the Framework. A phased implementation is likely to improve data quality, reduce implementation risk, and allow regulators and industry participants to gain experience of, and confidence in, the Framework, before introducing more complex assessment methodologies.

Question 28

Does the second factor for consideration proposed for weighting BLMs and FLMs risk excessive use of FLMs? If so, should we restrict this factor more explicitly? For example, to significant investments in assets affected by 'J-curves'?

Yes, we believe it does. We're supportive of forward-looking metrics (FLMs) but think backward-looking metrics (BLMs) are also important, as they represent a scheme's experience. From a member perspective, having an equal balance between the metrics is reasonable. Moreover, increasing the weighting to FLMs allows for potential gaming – for example, schemes that have recently changed their strategy may overweight to FLMs to appear better on paper, possibly masking some negative performance. We favour a near-equal FLM/BLM weighting. It provides a more balanced and accurate assessment of value, ensuring that performance isn't overly judged on unrealised expected performance. Strategies can change materially over time, and focusing too heavily on historic returns also risks penalising schemes that have made improvements designed to enhance outcomes.

In addition, 'manager skill' is inherently captured in BLMs, while the use of capital market assumptions in the derivation of FLMs often makes no (or spurious) allowance for this.

Question 29

Do you agree with the simplified approach proposed for multi-employer arrangements for year 1? Why or why not?

Yes, we agree.

Question 30

Do you agree with the simplified approach proposed for single employer arrangements for year 1? Why or why not?

Yes, we agree.

Question 31

Would the simplified approach be appropriate if it was applied on an ongoing basis, for all in-scope arrangements completing assessments, with consequences attached? In particular, we are interested in feedback in how it may impact the assessment outcomes of SETs, bespoke and legacy arrangements.

We don't believe it would be appropriate to apply the simplified approach on an ongoing basis. We envisage some situations where additional consideration would be needed (eg some organisations might rightfully want to receive credit or discretion for being outside the group).

As a result, we think there are certain instances where the approach might need to be tweaked. Legacy arrangements could distort comparisons and may need to be judged in a different manner. Single-employer trusts (SETs) may have characteristics that outperform the average comparator, but those advantages could be lost in a simplified assessment that relies on averages. Bespoke arrangements may deliver benefits that aren't captured by performance metrics.

Question 32

Do you agree with the proposal for multi-employer arrangement consideration of minimum, median and maximum? Why or why not?

Yes, we agree and believe it's consistent with the broader approach being proposed.

Question 33

Do you agree with the proposed actions for not value arrangements? Why or why not?

We support the proposed distinction between amber and red assessments. The amber process provides sufficient flexibility for trustees and IGCs to investigate the causes of weaker performance and implement remedial actions where improvement is achievable. We agree that arrangements receiving a red assessment should face a significantly higher threshold. A red rating indicates fundamental concerns regarding value. It should create a strong presumption that members would be better served through consolidation or transfer, unless there's clear evidence that shortcomings can be addressed within a reasonable period and without detriment to members. A one-year period is helpful, allowing for this to play out and test whether there's sufficient distinction between red (justify your continuation) and amber (you must improve).

However, we'd welcome greater clarity on the factors that would identify the difference between an amber and a light-green rating. We can envisage a situation for multi-employer arrangements where an amber rating on a subjective basis would never be given due to the consequences of not being able to accept new employers. As a result, these arrangements may be more likely to allocate a light-green rating, which may be problematic in situations where it isn't warranted.

Question 34

Do you anticipate that a shorter initial data collection period would create any practical or analytical challenges, and if so, how might these be mitigated?

We don't envisage any practical issues but anticipate some potential analytical challenges. There could be fluctuations between the first and second half of the year regarding processing volumes and service levels. For example, data collected from two quarters may not accurately reflect full-year activity and could therefore show some volatility.

This could possibly be mitigated through narrative explanation – for example, by explaining that unusually high or low processing times reflect a period of activity that would likely be smoothed out over the full year.

Question 35

Do you agree to proceed with data publication in November given the risks identified? How likely are these risks to emerge and what steps could we take to address them effectively?

We agree with the proposal to publish VfM data in November, shortly after publication of the assessment reports. This better supports the Framework's objective of assessing value holistically and reduces the risk that individual metrics are interpreted in isolation. While delayed publication creates some risk associated with access to non-public information, we consider these to be manageable through appropriate governance, confidentiality controls and regulatory oversight. In our view, the risk of stakeholders drawing inappropriate conclusions from partial information is more significant than the risk of selective disclosure during the assessment period. We therefore support the publication of the dataset alongside the corresponding assessments and narrative explanations.

Hymans Robertson expertise

If you'd like to discuss any of the points raised in this paper, please contact us.



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