Thinking outside the box



Summary

- There are concerns of VFM regulations being too prescriptive, but if done right this can be an effective way of encouraging good practices.
- Transparency is key to VFM and like-for-like comparisons should be supported, but there is a danger of focusing too much on the figures.
- VFM focuses on accumulation but these efforts need to be extended to decumulation, with adequacy of retirement outcomes taken into consideration.

As the new value for money framework takes shape, how can the industry move beyond box-ticking to deliver genuine value for pension savers?

In September, the DWP and FCA closed their joint consultation on a value for money (VFM) framework for pensions. The findings of this are due to be published but this is widely expected to introduce new requirements around how schemes demonstrate value for savers in terms of investment returns and costs incurred. The aim is to improve member outcomes through greater transparency, but in an industry inundated with regulations there are concerns that the framework could just become yet another compliance requirement.

"We support the motivations for the framework," says Schroders head of policy, Richard Fox, "however we are concerned that the breadth and depth of the framework, along with the sanctions for schemes with value challenges, mean there is a risk this becomes a box-ticking exercise where schemes try to

protect themselves. That's not what the regulators intend."

The hope, for some, is that VFM will come naturally to the schemes that have properly embedded Consumer Duty. Protiviti senior manager, George Sakwa, argues that, ideally, VFM should simply be a natural extension for pension schemes and not just another compliance exercise.

"The main tweak will be that the VFM framework will put that assessment in the public domain and allow for it to be compared to peers," says Sakwa. "Schemes that do this well will turn VFM from a rating into a source of competitive advantage."

Regulators may want schemes to take on the spirit of the rules but these are still compliance requirements at the end of the day. Sackers partner, Andy Lewis, says it would be wrong to downplay the compliance aspects of VFM, and not just because he is a lawyer. Instead, he warns against underestimating the requirements of this framework.

"Once that's up and running, there should be more scope to embrace the wider spirit of VFM," says Lewis, pointing to the mooted traffic light system for these reports. "For example, even if the official VFM rating is light green, or dark green, there could still be opportunities to improve – looking for potential opportunities thrown up in a scheme's assessment and making an action plan for next steps."

Shaping the framework

It's yet to be confirmed what recommendations made the cut in the consultation, but it's clear that many want a demonstrable link between regulation-mandated reporting and action.

"Transparency is important, but genuine improvement comes when schemes are encouraged to address weaknesses and demonstrate how they intend to improve member outcomes," says People's Pension head of business development, Max Gist. "Provider communications should go beyond simply repeating VFM ratings, explaining what the findings mean, how schemes compare and what steps are being taken to deliver better outcomes for savers."

This reflects the growing argument that reports alone will not stimulate change. In agreement is AllianceBernstein multi-asset portfolio manager, David Hutchins, who wants to see trustees demonstrating that they are prepared to act independently when the evidence demands it.

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"That means being willing to challenge providers, advisers and previous decisions, rather than allowing optimistic forecasts of future improvement to outweigh poor realised outcomes," adds Hutchins. "Those responsible for a decision should not be the only people determining whether that decision has been successful."

Designing the VFM framework also means doing so in a way that accommodates the numerous other regulations facing schemes. There is a risk, according to Sakwa, that VFM assessments could overlap with similar requirements under Consumer Duty and that the latter should be taken into consideration. Specifically, he says this can help influence how VFM reports demonstrate performance and fees.

"The Duty's consumer understanding test applies directly: Performance should be shown net of all charges, in pounds on a typical member's pot, against both comparators and the scheme's own objectives," suggests Sakwa. "Members also need context, such as how much of a return came from manager skill rather than the market return, and what level of risk was taken."

Context is key as the aim is ultimately for savers to make better informed decisions when comparing their schemes with others. However, AMNT co-chair, John Flynn, is wary about how comparisons influence scheme decisions.

"Better returns for savers will be driven by comparison between schemes and their colour rating but this will become less effective if there is 'herding' to a safe middle," says Flynn. "Members don't want schemes just focusing on making sure they are 'average' by being part of the pack and then boasting about it. All activities must be member centric and focused on member wellbeing."

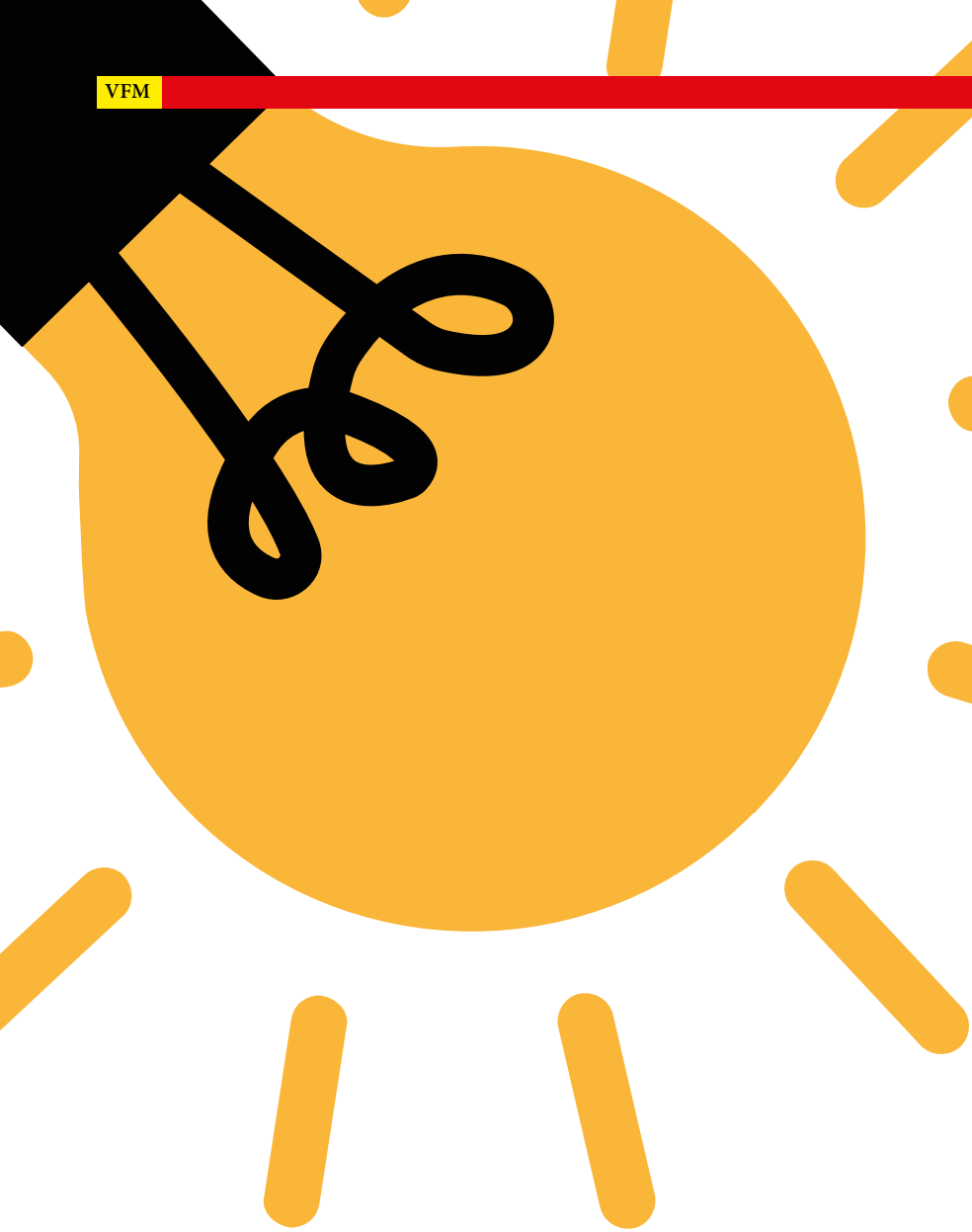
This brings the thorny issue of what 'value' actually looks like for members.

Defining value

Demonstrating value for a member is complicated by the fact some schemes are confused about what they should ideally be delivering. Recent research from Aon finds that 73 per cent of employers and trustees do not know the expected retirement outcome for a typical lifetime member of a DC pension scheme. According to analysis accompanying the findings, this represented a potential adequacy 'blind spot'.

"The VFM consultation gave a pretty clear signal that value in retirement is on policymakers' radar even if it is not being put into regulation yet," says Lewis. "There's no real consensus at the moment about how you assess value in retirement, and it's likely to be much harder than in the saving phase – this conversation will continue into the coming years."

There is no decumulation without accumulation, though. Zedra client director, Anne Sanders, sees the need for a thorough value assessment of the latter to improve the former, but she concedes this is a lot to deal with in one regulatory framework.



"A member's outcome is largely driven by the contribution level and the investment performance, with charges tending to play a relatively minor role in the total outcome, due to the charge caps in place," says Sanders. "It's hard to see either the FCA or TPR seeking to include adequacy measures into the VFM framework without an independent determination of what an adequate contribution rate or retirement benefit was."

The VFM consultation has so far focused on accumulation but the decumulation phase, and with it adequacy, is likely to be influenced by the upcoming findings from the Pensions Commission. Lewis sees these as "critical" and that greater conversations between business, government and society will be needed to face this. He adds: "Only then will we be able to work through the full interplay between adequacy and value."

In agreement is Gist who, while seeing a real role for VFM reports to play, recognises these are limited to assessing investment performance and administration. They can be useful for members and start conversations but schemes will then need to do more and take these further.

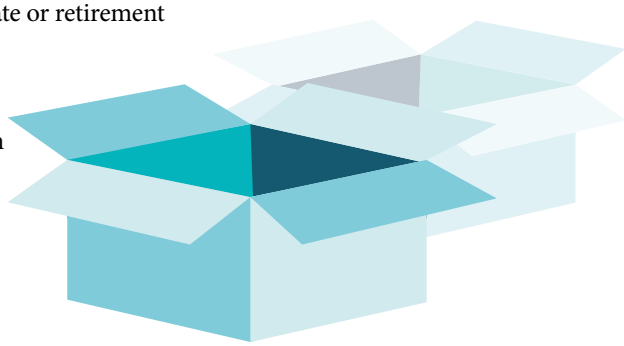
"Schemes need to help members understand what a good retirement might look like for them personally, while providing simple retirement pathways for those less comfortable making complex financial decisions," says Gist. "The future development of decumulation VFM measures should help members compare retirement options on a consistent basis."

The nuance here is that maximising a pot size may not necessarily be the right measure of value for every member. Here, Hutchins points to the difference of risk and objectives between someone planning to buy an annuity from someone intending to remain invested and draw an income.

"That makes clarity of objectives essential," he adds. "Schemes should be transparent about the outcomes they are designed to deliver and accountable for how effectively they deliver them.

A flexible VFM framework can recognise different member needs, but flexibility over objectives should not become flexibility over accountability."

A challenge here is the wide variety of retirement lifestyles that savings have to support, with this heavily dependent on personal circumstances. There is an opportunity for the VFM framework to improve member outcomes but it is apparent from those in the industry this will depend on a lot more than judging the value of a pension scheme while accumulating.



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