Submitted by email only: VFMdiscussionpaper@tpr.gov.uk and VFMdiscussionpaper@fca.org.uk

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Dear Lisa

SPP response to TPR and the FCA's Joint Discussion Paper: Driving Value for Money in defined contribution pensions

We welcome the opportunity to respond to this discussion paper.

Executive Summary/Key Messages

We applaud the aims of this discussion paper but we have concern that they are utopian. We have considered the pros and cons of the ideas set out in the paper and it is difficult not to conclude that there is no practical way of achieving them.

Whilst the ability for employers and trustees (and IGCs) to better understand whether their workplace pension is providing value for members is both understandable and necessary, we believe that the following are vital considerations as this discussion evolves.

1. Value can vary due to a member's specific situation and also over time. For example:

   - Adjusting the periods over which investment performance is measured by a matter of days or weeks can make a profound difference to the returns experienced. Whilst it would be wrong to allow the choice of the most favourable period of measurement, it could be equally wrong to impose an arbitrary time measurement period which does not reflect the true performance of a fund or strategy over time.

   - Different members with different joining and leaving dates, contribution amounts and cycles, transfers in and out etc, experience value differently.

   - Assuming the inclusion of communication in the value measurement, it should be noted that most statutory communications are required annually and that this, by and large, is templated and difficult to differentiate. More meaningful and effective engagement may take place more or less frequently. An assessment of communication should have scope to include non-statutory communications and the medium (eg paper, internet, presentations) by which this happens.

2. The value metrics in this discussion paper explicitly focus on accumulation only. We believe that this is a non-holistic and potentially misleading approach. Whilst we accept that not all schemes offer all options available under Freedom and Choice, it is difficult to see how decumulation cannot be considered to be an integral part of the value chain: for example:

- A member of Scheme A is required to transfer out to an alternative provider in order to take a flexible income. He or she is likely to experience an immediate transition cost of (for argument's sake) 1% and, assuming it is a transfer to a retail product, will then experience higher ongoing charges.
- A member of scheme B can access a simple, seamless and inexpensive drawdown option within his or her scheme.

All else being equal, it is clear that the member of Scheme B is experiencing better value from their membership than the member of Scheme A and this should be taken into account when discussing value for money.

3. We believe that employers and trustees of some schemes may rightly be persuaded that either their scheme can be improved to provide better value to their members or that better value lies elsewhere. However, we perceive a risk that some schemes which offer reasonable value will be encouraged into making precipitous changes where the outcome benefit to members could be marginal or even negative. For example, consolidation into scheme with marginally better VFM may actually be a poor decision for members once factors such as transition costs and loss of employer subsidy (e.g. for paying administration and other professional fees) are taken into account. This is especially so if decumulation (see 2 above) is disregarded from the assessment. Similarly, improvements made within a scheme to marginally improve VFM may actually worsen member outcomes when looked at holistically i.e. in the end the cost outweighs the marginal benefit. These risks must be taken into consideration and managed carefully.

4. We do not believe that different levels of climate change ambition and targets, or wider ESG factors, can or will bear direct comparison between schemes and nor do we believe that a value metric based exclusively on investment performance can reflect the changing priorities of trustees and members, tolerances and ambitions for sustainability, corporate and societal change. Extending this, might the imposition of return-only or risk adjusted returns value metrics create a situation whereby fiduciaries reduce their longer-term focus on climate and ESG?

Detailed Response

Q1. Do you agree that consistent disclosure of performance is necessary to enable better decision making?

We agree that performance information can support better decision making. We are already seeing that performance disclosure in the workplace market for sub-£100m schemes is supporting a better understanding of those schemes by trustees, employers and their advisers. However, decision makers need to acknowledge the limitations of that information. Schemes should not compete on recent performance, which fails to take account of long-term objectives such as ESG and volatility dampening.

The discussion paper only focuses on VFM during accumulation. Consistent disclosure in relation to decumulation is also a key element in better decision making.

Members are also decision makers and may be unduly influenced by publicly disclosed performance information. That information could, if unclear and subject to misinterpretation by media outlets, lead members to take decisions that are not ultimately in their best interests. For example, it could play into the hands of scammers who promise greater returns and are less transparent about costs.

We are also unclear how this framework would interact with the existing requirements for annual chair statements. Clearly it is in nobody's interests for there to be duplication, additional work for no benefit, or inconsistency between different documents. We are not sure if you have considered that aspect when you refer to "consistent disclosure" but, if you have not, we suggest you should.

Q2. Do you agree that comparisons should be of net rather than gross investment performance?

We agree that net investment performance best reflects savers' experience of investment return, and it ties in with the VFM assessments for sub-£100m schemes. However, savers will not always understand that they sometimes pay for things which can reduce returns in the short term but have a value (like volatility dampening). Care is required in how the investment performance is presented.

Q3. Do you have any suggestions on how to make disclosure of net investment returns effective given that there may be varying charges for the same funds within multi-employer schemes? For example displaying a range, or requiring disclosure of each different level of net investment performance.

We note that a similar issue was raised in the feedback to your PS21/12 and we suggest a similar approach is considered. Alternatively, we think that a range is sufficient for public disclosure purposes. Governance bodies and members should already have access to the particular investment returns that are relevant to them.

Q4. Would it be helpful to mirror the DWP's approach in terms of the reporting periods?

Governance bodies across workplace occupational and personal pension schemes should have the same reporting periods to allow comparisons. However, we note that many ESG funds are relatively new with little or no past performance data due to the rapid pace of innovation in that area. That might result in such funds looking less attractive.

Q5. Would publishing a set of metrics based on age cohorts bring investment performance reporting closer to the saver's investment performance experience of a pension scheme/product? If not, is there a better alternative we have not considered?

We agree that basing metrics on age cohorts is a good idea. Any standard metrics will need to take account of the fact that different schemes start their glidepaths at different ages, and savers of the same age within the same scheme may have selected different target retirement dates.

Q6. When considering which age cohorts to consider, is the example we have provided appropriate? Alternatively, would it be more effective to mirror the DWP's approach?

We prefer the example you have given, as the DWP's approach does not take account of the target retirement date a particular saver may have selected. To be clear, this matters when considering investment performance because in most cases the investment strategy is based on time to target retirement rather than age of the member. (This is an occasion when we feel that a different approach should be taken from DWP and in contrast to our answer to Q4.)

Q7. What disclosures, if any, should be made for self-select options?

The joint discussion paper is stated to cover not only workplace schemes (where only a minority of savers self-select their investments) but also non-workplace pension schemes (where self-select is the norm). There would be some justification in distinguishing between the two types of schemes. Workplace schemes could be required to disclose publicly performance information only for the default (unless a sufficiently large part of the workforce has self-selected another investment fund). Non-workplace schemes could be required to disclose information in relation to the most popular investment options.

Q8. Do you think reporting based on age cohorts would be enhanced through the use of risk-adjusted returns as an element of a scheme's VFM assessment or would risk-adjustment then be unnecessary?

We believe that reporting on age cohorts should be enhanced through using risk adjusted returns. However, care must be taken to ensure that this is not misleading because different levels of risk apply to different age demographics. For example, a lower net return which is compensated by a lower level of risk may be entirely inappropriate for a member with an investment horizon of, say, 20 or more years. A defence that 'investment returns were weak but the risk mitigation was high' should not disguise fiduciaries' poor investment strategy if the risk mitigation strategy itself was poorly timed.

Q9. If risk-adjustment is used, what risk-adjustment metric(s) would you suggest? For example, the Sharpe ratio as i) a standalone factor, or ii) in combination with other risk metrics?

We leave this question for investment professionals to propose a methodology that is acceptable.

Q10. Is there any reason why it would be impractical to report on risk-adjusted performance metrics in addition to providing a metric based on actual performance returns?

There should be no issues with such reporting if the final design of the risk-adjusted performance metric is universally implemented.

Q11. What are your views on presenting returns only as an annual geometric average to provide consistency with the DWP's requirement?

We believe that the longer-term nature of such metrics will be more advisable than short term metrics, although this could itself introduce distorted reporting when there are both long and short time periods being compared. Moreover, investment strategies can and do change with some regularity. What would be the value of including the performance of legacy investment strategies and, if it is to be included, would data be consistently available?

Q12. We would welcome views on how you see this developing. Would it be helpful/possible to establish a benchmark, or would you prefer to compare cohorts against a market average or against a few selected similar schemes? If so, how would that selection be made?

This depends on what the expected outcome is intended to be if poor value is identified. If the objective is improvement, then benchmarks and comparison of cohorts against a market average may be of some limited value, presupposing that action is then undertaken to improve (or improvement is mandated). However, using cohorts and/or 'a few selected similar schemes' suggests that the value assessment would then become relative rather than absolute. Fiduciaries and providers might gain an understanding of where they stand in that specific cohort/group, but since that cohort's value rating may be better or worse than any other dissimilar schemes/cohorts it would have limited effectiveness. Moreover, identifying similar single employer occupational schemes which have better value would be immaterial – they could not be used for consolidation purposes.

Therefore we consider that all three suggested options are flawed and that it would seem sensible – and simpler - to instead focus the comparison against a selection of commercial schemes (GPP or Master Trusts) who would be willing and able to consolidate if poor value was identified. We note your concerns in paragraph 37 of this chapter that the DWP requirements for schemes <£100m would not be appropriate for your purposes and ask for an explanation as to why you believe this.

Q13. Do you think a commercial benchmark is likely to emerge if these data are made publicly available?

We believe that this is unlikely given the amount of subjectivity that would be involved. As referenced elsewhere, any benchmark that does emerge would require a more holistic approach than is suggested in this Discussion Paper. As a minimum, value should take account of decumulation options and provider strength (as a proxy for withstanding financial pressures and being capable of continual product investment). And a perennial concern about establishing benchmarks is that this just leads to comparisons against an “average” and a resultant herd mentality which is unlikely to lead to a meaningful assessment of value for money.

Q14. Do you agree the quality of communication is a relevant factor to consider in VFM assessments?

Firstly, we are pleased you want stakeholders to take a holistic view of VFM and recognise that other factors apart from investment performance and costs should be taken into account.

We consider communication is an essential component in ensuring good member outcomes and therefore agree with the statement in this question. However, communication can be subjective and difficult to measure. As a proxy for communication, member engagement - both positive and negative – could be used on the theory that communication is working if members are engaging with the scheme.

Q15. Do you agree administration is a relevant factor that contributes to long-term VFM?

Yes, we agree with the statement in the question and the assertion in the discussion paper that scheme administration is fundamental to the running of a scheme. Service Level Agreements could help measure this and have historically been well understood within the industry.

Q16. Do you agree the effectiveness of governance is a relevant factor that contributes to long-term VFM?

Yes, again we agree with this statement. We consider it is fairly self-evident that a poorly governed scheme is unlikely to achieve good long-term VFM for its members.

Q17. In your opinion, are there any obvious service standards missing from the above list? Please explain how your suggestion contributes to scheme value.

Of the items listed in Fig 4, as we have already alluded to in previous answers, we suggest that post-retirement (i.e. decumulation) options will become more of an issue in the medium term as the majority of pension benefits being drawn become DC rather than DB. To date, there has been a large focus on accumulation of DC assets with members left to fend for themselves, to a greater or lesser extent. At the end of the day, members will judge VFM by how big their retirement income is and the choice of post-retirement options can greatly affect that.

Q18. Do you agree this is not a role for the regulators at this stage?

See Q.19

Q19. Would it be helpful to appoint a neutral convenor to develop a service metrics standard? If not, who do you think should create metrics on service in pensions

(We are answering Q18 and Q19 together.)

Firstly, we agree with your comments in paragraph 27, and have already alluded to the fact that measuring some of the factors in this chapter is subjective and quantitative assessment is not necessarily appropriate.

We would also ask that schemes are given enough time to improve standards in these areas. For example, improving communication – whatever that means – in a scheme may take several attempts over several years. If schemes are fearful of being forced to wind-up if they cannot improve over, say 12 months, then short term fixes and bodges are likely to become the norm rather than long-term meaningful solutions.

Whilst we recognise that the BSI has expertise in setting standards, we are concerned that TPR and FCA should not absolve themselves from responsibility for this – you are the regulators for pensions and should be involved in setting standards in this area.

We are also concerned that you have merely stated that the cost of a convenor "would have to be worked out". We consider that such a cost should be met by the regulators and/ or government directly. We would oppose any new levy to cover this cost and also note that the industry is already meeting considerable "invisible" costs through time commitment to help achieve policy aims such as the Small Pots Co-ordination Group and other initiatives such as PASA.

We also question whether the neutral convenor will find appropriately skilled staff to fulfil its targets and how the standard would be overseen in the longer term.

Q20. Do you think that over time independent certification against a standard is worth exploring for benchmarking service metrics? If not, what alternative arrangement would you suggest?

We can understand that the FCA and TPR wish to set minimum standards, however, as alluded to in Q19, the introduction of an independent entity to assess compliance with those standards appears to us to duplicate the roles of the FCA and TPR in the governance of contract-based and occupational pension schemes respectively and the role of trustees in relation to occupational pension schemes. Schemes would, presumably, still have to report against individual metrics in order to be awarded independent certification. Requiring independent certification would simply add another layer of cost (and administration), which, as noted in the Joint Discussion Paper, would inevitably end up being borne by savers.

Therefore our suggested alternative arrangement would be that FCA and TPR should take on this role.

Q21. Should we use the existing administration charges and transaction costs definitions in developing VFM costs and charges metrics?

Yes. In our view, at least for the time being, the existing administration charges and transaction costs definitions should be used in developing VFM costs and charges metrics. We agree that using the current definitions will better facilitate the use of the same metrics across the whole pensions landscape. Using the existing definitions will provide sufficient information to enable trustees (and employers) to generate VFM without the need for further granularity.

Q22. Would splitting out the administration charges be a more useful metric? If not, are there other definitions you think would be more appropriate?

We assume you mean by this splitting the current definition of administration charges into two components? If that is right, see our answer to question 21.

Q23. Do you agree we should introduce benchmarks for costs and charges?

No, we do not agree that benchmarks should be introduced for costs and charges. The use of benchmarks is appealing in theory. However, as noted in paragraphs 14 - 23 of the Joint Discussion Paper it is extremely challenging to find a benchmark option which does not have significant disadvantages of one type or another.

Q24. What are your views on our suggested options for benchmarking costs and charges? If not these options, what benchmarks should be used?

We agree with the flaws identified with the various benchmarks identified in paragraphs 14 - 23 of this chapter and therefore, as stated in our answer to Q23, we do not think benchmarks should be introduced. We have not been able to identify any alternative benchmarks for this purpose which avoid these, or similar, flaws.

We hope that our comments are helpful and would be happy to further discuss any of the matters raised with you.

Yours sincerely

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Chair, DC Committee, SPP

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Chief Executive, SPP

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