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Value for money: Where next?

6 MINUTE READ

Paul Armitage, DC Lead, Muse Advisory

"Value for Money" is a common-sense concept that we are all familiar with; that link between the cost of something, and its quality – and we constantly make a judgement about how well those are aligned. In the world of pensions, VFM (Value for Money, or Members – it has been both) is in the process of being defined.

The intention is to make identifying high-quality schemes – as well as those that need improving – easier and more accessible for all. The effort is going into creating metrics that score the quality of services and investments that lie behind all workplace schemes and identify value, rather than just focusing on cost. Furthermore, it makes comparison far easier – with the potential for league tables as an outcome.

A brief recap

For years value has been captured within the Chair's Statement for trust-based schemes. How this was done was largely left to the discretion of the Trustee Board, based on the not unreasonable comment by TPR that there is no suitable "one size fits all" approach that can be adopted, given the huge range of schemes being governed. However, there is an ongoing concern within DWP that only schemes of sufficient scale can truly deliver value – and we also believe there are clear benefits that come from scale, although there are some very well-run smaller schemes. This led to the Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021 - which introduced a VFM requirement specifically for trustees of schemes with under £100m of total assets.

The rules require the assessment to include a comparison of reported costs and charges and fund investment net returns against three other schemes, and a self-assessment of scheme governance and administration quality.

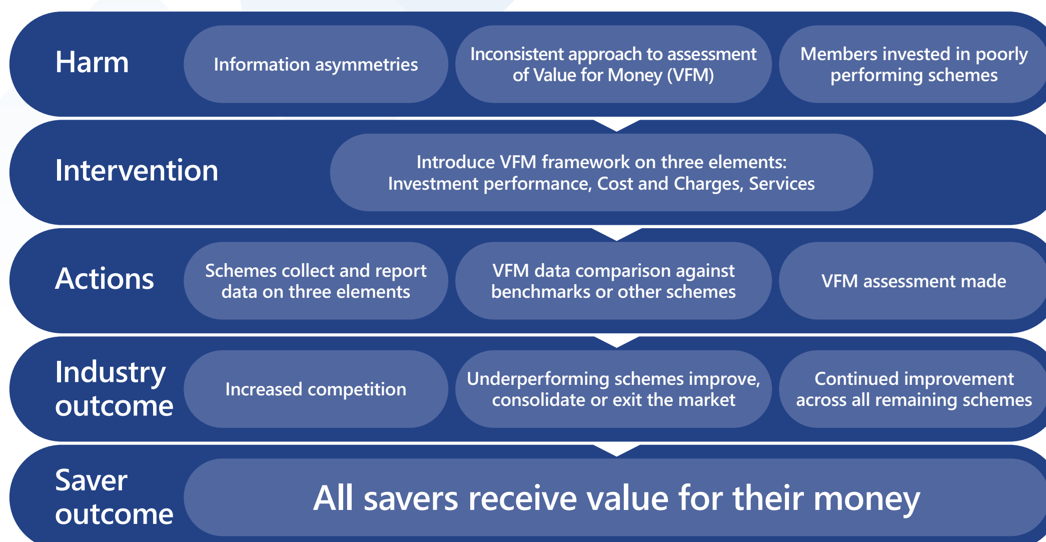
That self-assessment of administration and governance comes under seven headings; Promptness and accuracy of core financial transactions; Quality of record keeping; Appropriateness of the default investment strategy; Quality of Investment Governance; Level of trustee knowledge; Quality of communication with scheme members and Effectiveness of management of conflicts of interest.

Similar rules were brought in for the Independent Governance Committees overseeing contract-based schemes, to ensure complete coverage of the workplace DC market. The mantra from DWP that accompanied these new rules was a very clear "Govern or Consolidate"; the firm steer was that if schemes at £100m in assets or below could not demonstrate good value, they should consider consolidating into a multi-employer scheme such as a master trust, where scale was building quickly.

Fast forward

Fast forward two years and a few consultations later, in 2023 DWP published their new proposed framework for VFM – applying to all workplace schemes covered by both TPR and the Financial Conduct Authority (FCA). It's interesting to note the causal chain from a regulator perspective (see diagram below):

Figure 1: VFM Causal Chain



At high level, the proposals require the assessment and public disclosure of scheme performance against three key sets of metrics; investment performance, cost and charges, and service delivery to members. The (self) assessment will lead to a red ("poor"), amber ("could do better") or green ("good") rating for each of the metrics, with those responsible for the scheme expected to address areas in amber and red. The proposal is that members' interests will be protected where possible, with transfers to better providing performers taking place without member action.

Reactions are mixed

Market reaction to the proposals has been very mixed. On the positive side, the RAG system is very easy to understand and could make it far easier for members to identify a good home for the consolidation of pots, particularly once we have dashboards available that are expected to speed up pot transfers.

The same benefit applies to proposals to identify authorised "small pot consolidator" providers. The public nature of disclosure should speed up the closure and consolidation of schemes that have genuinely struggled to offer value, which we agree is needed; and employers will be in a better position to shop around for high performing schemes when setting up or reviewing a workplace scheme. The disclosure will ultimately replace chair statements.

There are however concerns that the RAG system is too simplistic; there are shades of each colour for every scheme, and making direct comparisons in areas such as investment performance are too difficult with different philosophies and approaches reflecting target markets – especially when considering the situation over time.

The proposal is that any rating other than a "green" essentially closes a scheme to new business; this could have a huge impact and unintended consequences for the commercials of providers investing in UK workplace. For example, we see this as unfair for providers with historic below average investment performance who have addressed this through a redesign, which is yet to impact longer term returns.

The "green" rating could also become a driver of "herding" by providers, each adopting a safe method of delivery to ensure they are "in the pack" for all three key metrics, stifling future innovation.

Devil is in the detail

At present, these are just proposals. The detail is still being worked on, and we do

not yet have a clear timetable for implementation. DWP has referred to implementing "in stages"; we need more detail on what this will mean in practice. Given the scale of data gathering and preparation for reporting required, the lead in time is going to be significant. A consultation process has happened, led by the FCA, but the expectation is that TPR will follow the outcome of that work to ensure a consistent approach.

It's also important to see how the VFM framework fits into the wider political landscape. VFM once implemented will drive the consolidation of schemes and lead to fewer, larger schemes requiring oversight. This aligns to the wider government agenda around "productive finance" that Rachel Reeves announced in the Mansion House speech in November 2024. This linked pension scheme scale to their ability to invest in the UK and support economic growth. This is an intended consequence of VFM, which will likely lead to more regulation.

In a nutshell, the policy aims of speeding up the consolidation of schemes that currently offer poor value and outcomes for members is an important one that we support. However, the detail of how this is implemented will have consequences that need to be fully considered.

This evolving environment in the DC space means the demand for selection exercises, benchmarking advice and support in scheme VFM analytics is increasing and is reflected in our own work in these areas. If you woud like to find out more, please contact **Paul Armitage** at paul.armitage@museadvisory.com.