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Value for money framework

On 7 August 2024, the Financial Conduct Authority (FCA) published a consultation paper, asking for views on its proposals to improve the value for money (VFM) individuals receive across the workplace Defined Contribution (DC) pensions market.

The aim is to reduce the number of savers investing in workplace pensions that deliver poor value.

The FCA has confirmed that it's working alongside The Pensions Regulator (TPR) and the Department for Work and Pensions (DWP) to develop the VFM framework. The consultation closed on 17 October 2024 and First Actuarial responded to the consultation.

The proposed framework has four elements:

- Consistent measurement and disclosure of investment performance, costs and service quality
- Making it possible to compare arrangements consistently and objectively
- Publicly disclosed Red/Amber/Green ratings
- Actions firms need to take when their ratings are Red or Amber.

The VFM framework will expand the work undertaken by the Independent Governance Committees (IGC) established by providers of contract-based workplace DC schemes.

Clearer comparisons across the DC pension landscape should lead to better value for individual policyholders without their having to take any action. This will allow those who are charged with overseeing and challenging a scheme's value to compare its performance against other arrangements. The public disclosure of assessment outcomes with a Red/Amber/Green VFM rating for each arrangement will support such comparisons.

Providers will have to notify employers of their rating each year. The FCA must also be notified of any Amber or Red ratings.

Providers must then deliver an action plan to outline areas where improvement needs to be made. For the second and third years, the plan will have to provide any updates on actions taken. If, in the fourth year, a default arrangement still fails to provide value, then it should be rated as Red, unless the firm can show that an extension will make VFM possible.

Given that this process extends over a number of years, we suggest that firms take action quickly if their arrangement is not delivering VFM – i.e. it's assessed as Red or Amber. In such instances, the FCA is proposing that the firm must consider transferring the affected savers, i.e. their employees, into an alternative arrangement that does provide value.

Broadly speaking, in our experience, the modern, open default arrangements are competitively priced with good evolving services and well governed investment strategies. While it's important to apply any value test to these arrangements, we would expect most of them to achieve a Green rating or be able to do so with relatively minor adjustments. If they don't, however, a question immediately arises – how will a company manage such a change in their scheme without appropriate support and guidance?

This ties in with something that First Actuarial has been championing for many years now. Employers should be maintaining robust ongoing governance of their DC pension scheme(s).

Robust governance underpins every area of the running of workplace schemes, including communications, processes and procedures. As such, scheme governance helps to ensure that propositions, investments and charges provide employees with value.

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In our view, the individuals most at risk of being in an arrangement that provides poor value – to the point of impacting retirement outcomes – are those current or former employees in older legacy arrangements, which are often closed to new business and/or new contributions.

They may sit on the legacy platform of a firm which is focused on the sale of alternative, newer products, or is managed by an organisation specialising in running closed books, and so not seeking to improve or modernise the product in place.

Either way, many of these arrangements don't benefit from the latest investment offerings and service developments, and are often administered on legacy terms, so individuals pay higher charges.

There should be an absolute focus on ensuring that any such legacy arrangements – irrespective of size – are included within the scope of the framework. We believe it's the individuals holding these policies who need most protection and support.

The pensions market has continued to evolve since firms first started to meet their auto-enrolment obligations, and we often find that many have not reviewed their scheme since.

When those schemes are reviewed, we often find that employees have invested in outdated default investment funds, paying higher than average charges and targeting retirement outcomes, which are not aligned to the way people now take their benefits, or to propositions where pension freedoms aren't offered.

While these developments focus on compelling the providers of these arrangements to effectively audit themselves, there is also a clear need for employers to ensure their arrangements are appropriate for them and their employees.

What should employers be doing now?

Employers should not wait for the new VFM framework before they check that their DC scheme remains appropriate and that they have suitable monitoring procedures in place.

To assist with this, we have developed our ***FirstEngage*** service – a package of DC services for employers keen to improve governance and safeguard regulatory compliance.

Find out more about our FirstEngage service.

Get in touch

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