ADDLESHAW GODDARD

Value for Money consultation

29 August 2024

The FCA is consulting on the introduction of a "Value for Money" (VfM) framework to provide a consistent framework for assessing the performance of DC pension arrangements, and to require pension providers to take action where an arrangement fails the VfM test. The consultation relates to FCA-regulated firms operating personal pension schemes, but ultimately the Government intends that equivalent frameworks will apply across the DC workplace pensions market (ie to occupational pension schemes too). Once fully in force, it looks likely that the VfM framework will impose significant additional compliance requirements on trustees of occupational pension schemes providing money purchase benefits, as well as on providers of personal pension schemes. We take a look at what we know so far about the proposed new framework.

On 8 August 2024 the FCA published a consultation on the introduction of a "Value for Money" (VfM) framework. The key idea behind this is to provide a consistent framework for assessing the performance of DC arrangements, and to require pension providers to take action where an arrangement fails the VfM test. The consultation relates to FCA-regulated firms operating personal pension schemes, but the FCA has worked with the DWP and TPR on the proposed requirements, and ultimately it is intended that equivalent frameworks will apply across the DC workplace pensions market (ie to occupational pension schemes too).

The proposed framework:

- requires the consistent measurement and public disclosure of investment performance, costs, and service quality by firms for in scope arrangements against metrics which the FCA believes allow VFM to be assessed effectively;
- is intended to enable those overseeing and challenging an arrangement’s value to assess performance against other arrangements and requires them to do so on a consistent and objective basis;
- requires public disclosure of assessment outcomes including a Red/Amber/Green (RAG) VFM rating for each arrangement;
- requires firms to take specified actions where an arrangement has been assessed as not VFM (Red or Amber).

Which arrangements will be in scope?

- Default arrangements, ie the arrangement into which a member's contributions will be paid under the auto-enrolment regime where the member makes no active choice; and
- "Quasi-default" arrangements (see below).

What is a quasi-default arrangement?

This is an investment arrangement within a pre-auto-enrolment ("legacy") workplace pension scheme which is not a qualifying scheme for auto-enrolment (AE). A legacy arrangement will be a quasi-default arrangement where it is used by at least 80% of employees and ex-employees of at least one employer in the arrangement. It includes an arrangement closed to new savers, but only where contributions are still being made to it.

Exemptions for some arrangements with less than 1000 members

The FCA proposes to exempt arrangements with fewer than 1000 members unless the arrangement is the scheme's only default or quasi-default arrangement or is its largest such arrangement by number of members. This means that a default or quasi-default arrangement will be in scope where it meets at least one of three tests:

- at least 1000 members;
- fewer than 1000 members but is the sole default or quasi-default arrangement provided by the scheme; or
- fewer than 1000 members, but is scheme's largest default or quasi-default arrangement by number of members.

The assessment criteria

The consultation proposes a detailed set of metrics for assessing an arrangement's performance. These include:

- investment performance, with the measure being a test that looks at past performance rather than future anticipated performance;
- costs and charges;
- quality of service.

The assessment process

The process to give an arrangement a red/amber/green (RAG) rating will generally be carried out by a scheme's independent governance committee (IGC) in the case of a personal pension scheme. An arrangement will need to be compared with comparator arrangements offered by at least three other providers. The consultation sets out detailed proposed rules regarding which arrangements can be used for comparison purposes. The consultation goes into some detail on the process to be followed, but IGCs will still have a level of discretion as to the ultimate rating.

Consequences of an amber or red rating

A firm that receives an amber or red rating will need to notify the FCA of that fact and provide the FCA with an action plan setting out how the firm intends to address the poor value. This will need to specify the intended outcome and timescale. An arrangement rated as providing poor value for four consecutive years will normally have to be rated red, even if an amber assessment would have been appropriate had the fourth year been looked at in isolation.

A red rating means that the IGC considers that the arrangement is unlikely to be improved sufficiently to deliver VfM within a reasonable period of time. The FCA proposes that firms will have to consider transferring savers in red-rated arrangements into alternative arrangements.

Our thoughts

The policy behind VfM is that the framework should operate consistently across occupational and personal pension schemes, but as we so far only have the FCA consultation, it's not always obvious how the proposed requirements will apply in the context of an occupational pension scheme. The existing consultation closes on 17 October 2024, so it will be some time before we see the relevant changes take effect. However, when they do, it seems likely that they will impose significant additional compliance requirements on the trustees of occupational schemes providing DC benefits, as well as on providers of personal pension schemes.
