PUBLIC

27th March 2023

Department for Work & Pensions
Caxton House
Tothill Street
LONDON
SW 1H 9NA

**Submitted by e-mail to:** pensions.vfmframework@dwp.gov.uk

Dear VFM Framework Team,

**CFA UK response to the DWP regarding the open consultation on 'Value for Money: A framework on metrics, standards, and disclosures'**

The CFA Society of the UK (CFA UK) welcomes the opportunity to respond to TPR's second consultation on this topic. CFA UK responded to TPR's first consultation on the DB Funding Code back in September, 2020[1] and are pleased that many of our recommendations have been taken forward.

We provide more detailed responses to some of the specific questions in the consultation in Appendix II. However, we would like to emphasise the following overall observations:

1) We welcome the fact that it's a joint FCA, DWP and TPR consultation; we called for an aligned approach across all three regulators in our report back in 2018[2]. We are also very encouraged to read the restated focus on "not just about costs" and "long term view".
2) It is not immediately clear from the consultation who it is specifically aimed at. We believe it would help inform the debate to provide clarity on what each stakeholder's desired outcome(s) or action(s) are:
   a) Employers (or their consultants) choose the scheme their employees are enrolled into; but not all employers compare the value and performance of schemes when making that choice, it often comes down to cost to the employer and the functionality (for example integration with payroll) which limits their operational risk and resource burden.
   b) Informing members is the focus of much of the consultation. However, the vast majority of pension savers are not engaged and nor do they make active choices. We believe it is extremely challenging to create any sort of reporting framework to provide pension scheme members with the necessary information to drive optimum decision making based on VFM. Indeed, the complexity of the task and the lack of

[1] CFA UK response to The Pension Regulator's ("TPR") Consultation on the DB Funding Code (Sep 2020): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-uk-response-to-the-pension-regulators-tpr-consultation-on-the-db-funding-code.pdf
[2] Value for money: A framework for assessment: Nov 2018: https://www.cfauk.org/professionalism/research-and-position-papers/value-for-money-a-framework-for-assessment#gsc.tab=0

expertise and engagement amongst pension scheme members means that there is a very real risk that it in fact may achieve the opposite.

c) Trustee action is also referenced as an outcome in the consultation, for example a desire to give trustees the ability to challenge asset managers. We believe that the due diligence conducted by trustees on pension providers and fund managers is paramount to their delivery of value for money to members. Indeed, we believe that the policy aim, as we take it to be, would be much better achieved by raising the expectations upon trustees to have the skill, experience and time to execute their responsibilities, particularly in regard to due diligence. The ability to compare schemes across all metrics (not just investment performance) is important for trustees, but we are not convinced that all the proposed new reporting requirements or heuristics on their own will help trustees to short-cut due diligence and still arrive at the right outcomes.

3) We caution against focusing only investment costs, to the neglect of the other costs which members bear. Many pension schemes are built and rely on legacy systems which are expensive to operate and carry higher administration charges. Considering the broader member cost breakdown (and not just the investment cost) will help with the assessment of VFM, but again this should be part of suite of considerations undertaken by trustees and should not need to be codified into a public disclosure requirement.

In line with our Society's purpose, we aim to highlight relevant issues to help the investment community to serve its stakeholders well and to build a more sustainable future.

We appreciate the opportunity to respond to this consultation and thank TPR for collaborating with the FCA and DWP and for its ongoing engagement with this important project.

Yours sincerely,

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With thanks to contributions from:
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and the oversight of both the Pensions Expert Panel and the Professionalism Steering Committee.

**APPENDIX I: About CFA UK and CFA Institute**

**CFA UK** serves nearly twelve thousand leading members of the UK investment profession. Many of our members work with pension funds, either managing investment portfolios, advising on investments, or as in-house employees responsible for pension investment oversight.

The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.

Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information and career support on behalf of its members.

Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

**CFA Institute** is the global association for investment professionals that sets the standard for professional excellence and credentials.

The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.

It awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.

CFA Institute has members in 162 markets, of which more than 170,000 hold the Chartered Financial Analyst® (CFA) designation. CFA Institute has nine offices worldwide and there are 158 local member societies.

For more information, visit www.cfainstitute.org.

## APPENDIX II: Responses to questions

***Q1: Do you agree with the proposed phased approach?***

The proposed phased approach gives the opportunity to test the VFM framework and learn from its outcomes. However, the primary purpose of a pension is to provide for savers while in retirement. As such, decumulation is just as important as accumulation and so we believe decumulation should also form part of the first phase of the VFM framework.

Additionally, as we explore further in our response to question 5 below, there may be many good reasons to pay higher investment costs for a lower total return, for example through sophisticated risk management strategies, which is especially true in the de-risking and decumulation phase of a DC pension journey. At the same time, a cursory glance at the market for income drawdown investment solutions suggests this is a realm of generally fairly basic and low-cost portfolios whilst carrying higher, retail fee levels and structures.

The new VFM transparency requirements will need to be cognisant of this and avoid contradicting themselves when that phase is rolled out.

***Q2. Do you agree with our focus on and approach to developing backward-looking investment performance metrics?***

As CFA UK has noted in previous consultation responses, while we support the desire for consistency of reporting by member age cohorts, schemes' glidepaths (and hence their asset allocation changes towards decumulation) are often dictated by "years to retirement" rather than by a members age. Providing transparency on how asset allocation changes as a saver approaches retirement will enhance member disclosures and support member engagement. It will also support the policy intent of improving scheme comparability for members.

We applaud the consultation's desire to "reflect member experience" and we support the approach of using time weighted returns. While we note there may be a temptation to use the money weighted return metric to establish true VFM, we believe however that this could actually obfuscate things more.
Each member's savings journey and the returns that they actually realise is unique and is most accurately captured by money weighted returns. A members' money weighted return is determined to a large (arguably primary degree) by the size and timing of their contributions and this is a variable entirely outside of the control of the pension scheme or any fund manager. Hence, trying to make an inference of VFM - that is, the value delivered by a scheme or its fund managers for the fees paid - is fallacious. In the extreme example, a member who makes a contribution just before a market crash and crystalises shortly after will have a money weighted return which on the face of it would suggest that their experience of VFM was chronic, but the scheme and other cohorts could have benefitted from a high quality scheme with excellent investment sophistication which managed to considerably dampen the worst effects of the market downturn.
Furthermore, we refer to the CFA Institute's globally recognised GIPS standards[3] that require that the return must be calculated using a methodology that incorporates the time-weighted rate of return concept.

[3] http://www.gipsstandards.org/wp-content/uploads/2021/03/calculation_methodology_gs_2011.pdf

In terms of reporting periods, it should also be observed that automatic enrolment is still relatively young and as such, reporting periods at 10 and 15-year periods will not be possible. A "since inception" reporting period may be considered for those schemes that are only able to report for the 1, 3 and 5-year periods.

***Q3: Do you agree with our proposals to use Maximum Drawdown and/or ASD as risk-based metrics for each reporting period and age cohort?***

As noted in question 2, automatic enrolment (AE) in particular is relatively new and as such, any risk-based metrics will reflect more recent market situations. For example, since AE's establishment there have been significant market events (e.g. quantitative easing and the Covid 19 pandemic) which the Maximum Drawdown metric will reflect.

While we believe that risk metrics are indeed important, when it comes to ASD it could result in trustees then considering private markets and illiquid assets as exhibiting "more risk" (particularly if compared to other asset classes in benign market conditions) and hence negatively affect the scheme's VFM output. This could lead to trustees choosing perceived relatively safer assets to do better on VFM assessments, but this may not necessarily result in better outcomes for savers. We would highlight that CFA Institute's globally recognised GIPS standards[4] require the disclosure of an annually rolling figure of the 3-year mean average (rather than the 1-year) ASD to dampen the impact of short-term volatility in any one year.

***Q4: Do you agree with our proposals on "chain-linking" data on past historic performance where changes have been made to the portfolio composition or strategy of the default arrangement?***

We support the approach of chain-linking where investment strategy has changed for the broad saver group. Reporting investment metrics based on performance since inception (rather than based solely on current investment strategy) more closely mirrors the returns and risk experienced by scheme members and avoids a situation where a new strategy is pursued simply to mask previous poor performance.

Where mergers have occurred, we welcome the proposal of not applying the same chain-linking methodology, particularly where, as highlighted in the consultation, a legacy scheme has poor investment performance. In this case however, we would encourage the DWP to publish guidance on how VFM should be presented for those savers in the legacy scheme. Where the decision is made to merge legacy members into the consolidator's default, it would be sensible for a limited historical return record to be presented up to the point of consolidation, after which the default return is presented.

***Q5: Do you agree with proposals for the additional disclosure of returns net of investment charges only?***

Our interpretation of this proposal is that a scheme would calculate and report absolute investment returns net of investment fees and costs, including transaction costs, but gross of all other scheme charges from (a "gross/net" calculation") such as those arising:

- Scheme administration
- Corporate overheads including staff remuneration
- Any profit margin or excess net income.

[4] https://www.cfainstitute.org/en/ethics-standards/codes/gips-standards

We do not support this proposal for a "gross/net" calculation for the following reasons:

- Firstly, we note that this is a theoretical number: ultimately scheme members only benefit from the returns net of all costs and charges. We therefore highlight that such a figure would constitute an inflated return versus the reality that members experience after the deduction of all overheads.
- Secondly, it is not clear to us how a trustee should compare and interpret these numbers. Instead, we are concerned that such a comparison could give rise to interpretations that run contrary to what we believe is the DWP's policy intent with these requirements.
  - In order for someone to infer how much of the scheme's return is 'spent' on investment charges, they would also need to have the return number gross of all charges.
  - We assume the DWP's intention for this reporting is for trustees to be able to see the value of spending more, rather than less, on investment through the lens of returns – but with this reporting requirement, by comparison with already required 'net-net' returns, what trustees can only determine is the drag created by non-investment costs. Whilst this may, in fact, be a useful insight, we don't believe it is the one that the recommendations seek to achieve.

We believe the benefits of paying for more sophisticated investment strategies are borne out by diversification, resilience and quantitatively, enhanced risk-adjusted returns – but not absolute returns. Put another way, a scheme that invests entirely in passive global equity, for low single digits basis points, might have higher expected returns than another scheme that is charged more for a slightly more diversified equity and bond portfolio. Yet, the latter scheme would most likely have a higher Sharpe ratio and be a far more prudent approach for most pension savers. However, through the oversimplifying lens of the proposed "gross/net" comparison it would appear to offer lower returns and cost more.

Unfortunately, this problem cannot be resolved simply by having a risk-adjusted metric and using a "gross/net" numerator as the introduction of a further variable, in the denominator, only muddies the waters even further.

As noted above, investment charges generally neither dominate the member charges in DC schemes or account for the drag on performance. While the question of VFM in pension investing remains crucial, we question whether investment costs alone deserve so much attention to the omission of other cost elements. Creating transparency on the magnitude of non-investment costs as well as investment costs would allow stakeholders to focus on what we believe is, today, a source of value leakage for many members' pension pots.

We believe that trustees should, and already do, have the obligation to examine the full scope of services that a pension proposition offers, and the costs associated with those services; we believe that the DWP would get far closer to their policy aims by underscoring this duty.

At this point we should stress that CFA UK is not an industry body, and as such we have no vested interest whatsoever in arguing for regulations that enable or protect investment managers' ability to charge pension schemes higher fees. Instead, we seek to, amongst other things, champion best investment practise across the industry. With that in mind we want to stress that there is indeed merit in investment costs becoming a greater share of their members' fees, proportionately, than many have in the past. Investment management fees and investment costs in the pensions sector have come down considerably in recent years – in large part thanks to the DC charge cap, and relatedly the competition from low-cost passive investment strategies.

As we believe the DWP recognises, there is value in schemes a) diversifying and b) diversifying into the more expensive private markets. Indeed, we believe that recently the DWP has moved to accept the need for schemes to pay contingent performance fees in order that they are able to access more sophisticated private investments and pay more for greater returns. However, crucially, we do not see the correlation between investment costs and absolute returns to be sufficiently strong, reliable or intuitive for this focus to achieve the policy aim.

Ultimately, we recognise that it is very challenging to create an enhanced VFM reporting regime for pension schemes that effectively balances transparency against protecting commercial sensitivities. Clearly, pension schemes need to be able to confidentially negotiate fees with their fund managers to achieve lower fees and value for money. However, it does have the effect that any reporting at the level above which protects these details necessarily involves complex and potentially ambiguous interpolations and inferences.

Lastly, we would also note that in considering which elements fall outside of 'investment charges' for these purposes would also require further guidance on how schemes should categorise the cost of a scheme's fund administration services – we could see valid arguments either way.

***Q6: Do you agree with requiring disclosure of asset allocation under the eight existing categories for all in-scope default arrangements?***

We agree that disclosure of asset allocation will help decision-makers interpret data on investment performance and would add that a description of investment approach will enhance VFM assessments. We would however encourage consideration of how asset allocation by age point is presented, particularly prior to when de-risking occurs, and the allocation is broadly similar. Asset allocation by age point could result in a huge amount of data being presented to members which may be difficult to interpret.

We would also reference the CFA UK's response to question 3 of the DWP's previous consultation 'Broadening the investment opportunities of defined contribution pension schemes'.[5] Classification of assets should be approached with thought and as noted previously, we urge the drafting to avoid making naïve assumptions that pension schemes only invest in certain types of investments in certain geographies; schemes have broad investment powers and many or most aim to be globally diversified. We therefore strongly encourage a careful and nuanced definition of asset classes.

***Q7: Do you think we should require a forward-looking performance and risk metric, and if so, which model would you propose and why?***

By their nature, pension schemes are providing a future pot of money for savers and scheme members can see a projected retirement pot on their pension statements or online. It is therefore reasonable for schemes to publish a target forward-looking performance and risk metric (or both). Indeed, this may already be available to agree from many schemes as supporting materials around their Statutory Money Purchase Illustrations.

[5] CFA UK response to the DWP regarding the open consultation on 'Broadening the investment opportunities of defined contribution pension schemes' (November 2022): https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/response-to-dwp-v5-final-to-dwp.pdf

It is however paramount that any forward-looking metrics are framed as targets over the long term and are communicated as such to members. Any poor performance against these targets in the short term could result in members ceasing their contributions or switching investment strategies frequently which would not be a desired outcome.

We would also encourage consideration of who will be carrying out the modelling of the forward-looking metrics. IGC's and trustees may not have the ability to run this modelling in house which could mean this falls to consultants, which results in increased costs for running the scheme.

***Q8: Are there any barriers to separating out charges in order to disclose the amount paid for services?***

We believe that trustees should absolutely know what they are paying for and in bundled solutions should unpick the drivers of the total cost.

We do not, however, believe that this should be required to be placed in the public domain. If a services provider cannot strike a lower fee with one client versus another, given the broad commercial considerations, if that is at risk of being broadcast to all other clients then they will simply raise their average fees which would be to the detriment of clients as a whole.

***Q9: Do you have any suggestions for converting combination charges into an annual percentage? How would you address charging structures for legacy schemes?***

The FCA handbook (COBS 13 Annex 4) details the Reduction in Yield methodology which expresses the impact of all charges on savings, investment or pension pots over a period of time. It models the effects that applying charges will have on the resulting values of an investment.

To simplify the charging approach, we would recommend that the Reduction in Yield methodology is implemented. A notional member contributing and paying combination charges is simulated with some return profile. The gross and net pot size is compared over time and can be converted to an equivalent AMC drag.

***Q10: Do you agree with our proposal to provide greater transparency where charging levels vary by employer? Do you agree that this is best achieved by breaking down into cohorts of employers or would it be sufficient to simply state the range of charges?***

Employers should be aware of the charging level that applies to their scheme and this should be transparent to them. However, as noted in question 9, it is not necessarily beneficial for the charging level applicable to each employer to be published due to the commercial decisions that schemes may take when acquiring employer schemes. Disclosure of charging levels by employer cohort or by a range of charges that could apply to the scheme is preferable.

***Q11: Are these the right metrics to include as options for assessing effective communications? Are there any other communication metrics that are readily quantifiable and comparable that would capture service to vulnerable or different kinds of savers?***

While these metrics are sensible, it could be argued that these are minimum standards that should apply to all schemes (particularly the first metric) and do not automatically result in good VFM.

Given the contribution to overall charges that communication (and indeed overall administration) adds to a member's fees, we believe that it should be clear, effective and understandable.

***Q12: Are these the right metrics to include as options for assessing the effectiveness of administration and/or are there any other areas of administration that are readily quantifiable and comparable?***

We have no comment.

***Q13: Do you agree with a decentralised or a centralised approach for the publication of the framework data? Do you have any other suggestions for the publication of the framework data?***

In deciding whether a centralised or decentralised approach would work best, we would encourage consideration of who the comparison data will be most useful for.

If the primary audience is pension scheme members, then a centralised approach would make more sense. This would enable savers to compare schemes easily rather than going to each providers website. However, members are generally disengaged and the choice of provider often sits with the employer so how useful will the centralised approach be to a pension saver?

A centralised approach will also make it easier for regulators to “police” provider offerings.

If the primary audience is trustees, then a decentralised approach be more sensible. It would mean that scheme trustees only need to focus on their scheme and employers can look at what their employees are invested in and paying for already. However, a decentralised approach could make comparison harder. If a comparison site is used (with appropriate accreditation as noted in the consultation) then this could address the lack of ability to compare when decentralised, but data would need to be presented in an impartial way to avoid unconscious nudges to employers.

***Q14: Do you agree with the proposed deadlines for both the publication of the framework data and VFM assessment reports?***

We have no comment.

***Q15: Do you think we should require comparisons against regulator-defined benchmarks or comparisons against other schemes and industry benchmarks?***

Applying a standard benchmark to all schemes remains a challenge as every scheme is likely to have a different investment philosophy and strategic asset allocation. Prescribing benchmarks could mean that schemes are comparing themselves against a benchmark that doesn’t make sense and as a consequence, could be incorrectly classed as not providing value for when in fact it is.

Similar issues are present when benchmarking against comparator schemes as there is unlikely to be a clear read across between different investment approaches and allocation. Comparator schemes benchmarking will also need to be closely policed in order to prevent the potential to game the outcome.

We refer to the CFA UK’s paper[6] on what makes a good benchmark and would encourage any policy outcome to ensure that the chosen approach aligns to these characteristics.

***Q16: Do you agree with the step-by-step process we have outlined, including the additional consideration?***

We have no comment.

[6] CFA UK Position Paper on Benchmarks & Indices: https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/3-research-and-position-papers/benchmarks-and-indices.pdf

***Q17: Do you agree with a 'three categories' / RAG rating approach for the result of the VFM assessment?***

A RAG system is easily understood and is utilised in many consumer settings. We would also welcome consideration and guidance on how a scheme can demonstrate that it is continually improving even once it has achieved a "green" rating.

***Q18: How should we take into account the specific challenges of contract-based schemes while ensuring equivalent outcomes for pension savers?***

We have no comment.

***Q19: Do you agree with our proposals on next steps to take following VFM assessment results, including on communications?***

Communicating the outcome of VFM assessments to employers makes sense, irrespective of what the outcome of the assessment is. We would however encourage consideration of the scenario where an employer has been made aware that their chosen scheme is poor VFM (and does not appear to have a plan to rectify this) but does not take any action. This could be particularly relevant for smaller employers, where integration with payroll is a more important attribute to the employer than the VFM assessment and could lead to a less optimal outcome for members over the longer term.

***Q20: If the Chair's Statement was split into two separate documents, what information do you think would be beneficial in a member-facing document?***

As noted in previous responses, consideration should be given to who the documents are for and why. Most members do not engage with the communication from their scheme, particularly when they are many years from retirement. Producing documents that are overly complicated and that members do not read could result in a waste of resources.

The framing of member-facing documentation and what actions are being taken as a result are also key. If a member reads a document that has RAG'ed their current scheme as red for VFM and their employer chooses not to switch schemes, there is a risk that the member stops contributing all together.

***Q21: Is there any duplication between the VFM framework proposals and current Chair's Statement disclosure requirements?***

We have no comment other than to encourage that any duplication between the Chair's statement and the VFM assessment are minimised.

***Q22: Should individual SIPP arrangements be excluded from the requirement on providers to establish an IGC/GAA and to publicly disclose costs and charges and, if so, under what circumstances?***

Individual SIPPs are extremely diverse and arguably as unique as the savers to which they belong. Applying the VFM requirements to SIPPs across the industry is likely to result in additional resources and in additional costs which would not necessarily be in line with the policy intent.

***Q23: Do you think there would be merit in a proposal to mandate the inclusion of a pension saver-focused summary alongside the IGC Chair's Report?***

We have no comment.

***Q24: Do you think the provider or the IGC should be responsible under FCA rules for the publication of framework data?***

We have no comment.

***Q25: Which of the metrics do you not currently produce? (This could be for either internal reports or published data). Do you envisage any problems in producing these metrics?***

We have no comment.

***Q26: Do you agree with our assumptions regarding who will be affected by the framework?***

We have no comment.

***Q27: Are you able to quantify these costs at this stage? Are there additional cost components we have not considered? Do you expect these costs to be significantly different for commercial providers and multi-employer schemes?***

We have no comment.

***Q28: Overall, do you think the benefits of the framework outweigh the costs? Are you able to quantify any of the potential benefits?***

We have no comment.

***Q29: Are there additional benefits we have not identified?***

We have no comment.

***Q30: Do you have any comments on the potential positive and negative impacts of these proposals on any protected groups, and how any negative effects could be mitigated?***

We have no comment.