

## **Financial Conduct Authority (FCA)/ The Pensions Regulator (TPR) Consultation**

### **CP26/1\*\* The Value for Money Framework: Response to consultation, further consultation and discussion paper**

#### **Submission by the Financial inclusion and Markets Centre (FIMC)**

#### **About The Financial Inclusion and Markets Centre**

The Financial Inclusion and Markets Centre is a dedicated unit of the Financial Inclusion Centre which focuses on financial services policy and regulation, financial market reform, and evaluating the economic, environmental, and social utility of finance. The new unit also covers work evaluating the impact of developments at the intersection of finance and technology including AI.<sup>1</sup>

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<sup>1</sup> [About | The Financial Inclusion Centre](#)

## Introduction

We are pleased to submit a response to such an important consultation. For further information, please contact Mick McAteer [mick.mcateer@inclusioncentre.org.uk](mailto:mick.mcateer@inclusioncentre.org.uk) We are unable to respond to all of the questions so we have focused on issue that will have the most impact on consumers and markets.

## Summary of our submission

As we said in our response to CP24/16, we are supportive of the basic idea of VFM assessments of charges and service quality. The FCA/TPR has clearly put much thought into developing a workable VFM framework. But we are very concerned about the degree of emphasis placed by the FCA/TPR on investment performance, particularly past performance, in the proposed VFM framework.

Superior investment performance may well end up offsetting higher costs and charges. But, that cannot be said to be down to predictable *ex ante* skills on the part of the investment manager, consultants, advisers, and other intermediaries. It is very important to recognise that investment based services are not like consumer products or motor cars where the past performance can be used to determine the likelihood of future performance. By allowing past investment performance to be the core of a VFM assessment, the FCA/TPR risks misleading pension savers and distorting the market.

We have made significant progress in driving down charges and costs in the UK pensions and investment industry including through the use of the workplace pension charge cap. The weakening of the workplace pension charge cap and now this VFM framework threatens to reverse this progress. The VFM framework with its emphasis on investment performance will just allow investment managers, consultants, advisers, and other intermediaries to divert attention from the importance of costs and charges and actively promote and sell high cost, complex investment strategies which actually offer little added value but introduce greater risk.

It also risks causing more pension assets to be invested in high cost, complex, opaque, poorly regulated and governed 'alternative' investment assets and vehicles with questionable past performance track records and future prospects. Overall, we think the proposed framework is likely to result in poorer quality and value outcomes for ordinary pension savers and investors and less efficient allocation of resources by financial markets.

Worryingly, the proposals on Backward Looking Metrics (BLMs) and Forward Looking Metrics (FLMs) in this consultation could lead to even worse outcomes than those proposed in CP24/16. Moreover, it is disconcerting that the FCA/TPR is intending to allow firms to select their own assumptions about future performance rather than mandate standardised assumptions to prevent the system being gamed.

## **Response to specific questions**

**Question 1: Do you have any comments on the proposed scope? Do you believe any further exemptions should be considered?**

**Question 2: Do you have any comments on our proposals in relation to unlinked members? Do you have any preference with regard to the options suggested? Are there alternative options you would like to suggest?**

Rather than specify which particular arrangements are to be actively included within the regime, it would be preferable for the FCA/TPR to adopt a permissive approach by drafting rules allowing for all relevant arrangements to be included. This does not mean that all the specific rules need to apply to all arrangements immediately. These could be 'switched on' at a later stage if evidence of harm to scheme members deems it necessary. This would provide for greater flexibility and agility to respond to emerging detriment.

**Question 3: We do not think this situation would arise for trust-based schemes. Do you agree with this understanding?**

No comment.

**Question 4: Do you agree with this proposal for transferred members? Why or why not?**

We do not agree with the principle that members may be moved to another scheme without being consulted and without their consent. However, it seems that the Government and the regulators are determined to implement this approach. Therefore, we agree with the proposal outlined as a means of limiting the potential harm. Moreover, as a further safeguard, we believe that the TPR/FCA should establish a mechanism allowing scheme members to challenge a decision to move them without consent. An independent panel should be established to consider any objections by scheme members and make a ruling on whether the decision to transfer is indeed in the interests of members.

**Question 5: Do you agree with our proposed exemptions for contract based arrangements? Why or why not?**

We certainly do not agree with these proposed exemptions. For example, we have serious concerns about the inherent conflict of interest in Part VII transfers and the role of the 'independent expert'. We are of the view that these transfers are too often designed to deliver commercial benefits to the insurer rather than the policyholder/ groups of policyholders.

The proposed VFM framework is intended to deliver more transparency and accountability. It is precisely during events like these that a more robust framework is needed.

Nor do we understand why in the case of trust-based schemes where trustees who have decided to wind up the entire scheme would be exempt from the need to produce a VFM

assessment if they have notified TPR under section 62(4) or (5) of the Pensions Act 2004 that the winding up of the scheme in question has commenced. There is a risk that trustees and their advisers would be able to conceal the fact that they had been responsible for poor management of the scheme. Applying the VFM framework would allow for greater transparency and accountability by enabling TPR/FCA to assess the fitness and propriety of trustees and advisers.

**Question 6: Do you agree with the proposal to use arithmetic averaging instead of geometric averaging? Why or why not?**

No. We would say that the geometric averaging approach is accepted as providing the more accurate assessment of investment performance over time. The arithmetic averaging approach overstates the actual performance of an investment portfolio. This may not make much difference over short term periods but the difference does accumulate over time. At a time when we have seen major advancements in data capabilities (and AI), it is not too much to expect schemes and providers to use geometric averaging.

**Question 7: Do you agree with our proposed disclosures to facilitate comparisons between multi-employer arrangements with variable charges? Why or why not?**

We agree with the proposal to disclose the maximum, median, and minimum for the relevant metrics and that this should apply to the saver not the employer. Although clearly to aid transparency and accountability, some form of metric would be necessary at the aggregate employer level to allow for comparison of the charges paid by different scheme members within a multi-employer scheme. If scheme members from one employer are paying more in charge than similar scheme members from another employer, then this should be explained by the relevant governing body and reported to the TPR.

**Question 8: Do you agree with our suggested approach for mapping the performance of TDFs with multi-year cohorts for the purposes of deriving the relevant performance data?**

Yes. But, see comments about geometric averaging, above.

**Question 9: Do you agree with our proposed risk metrics? Why or why not?**

No. We believe that the MDD and geometric mean approach remains the best approach to show the reality of performance, including the magnitude of potential negative performance.

**Question 10: In light of the role that total costs and charges play in the calculation of net performance, we would be interested in views on whether chain-linking should be applied to costs and charges or if there are alternative suggestions that achieve more accurate reporting of net performance?**

We have no comment on the particular options for weighting. However, as we explained above, we believe that geometric averaging is more appropriate.

More important is recognising that the risk here is not that good reported performance might be diluted. The real risk is that high charging schemes will be able to downplay the impact of high charges on member outcomes and overstate the likelihood of good past performance being repeated. In the example mentioned in the consultation, if a lower cost arrangement A is merged into a higher cost arrangement B then it will be the charges applied on B that will determine the outcome for the members. So, it is right that the higher charges should be applied to the merged scheme. If arrangement B had managed to produce better historic performance then that will have been down to luck rather than skill. To reiterate, the FCA/TPR must know that future good investment performance cannot be predicted - past performance is no guarantee of future performance.

**Question 11: Do you agree with our proposals for chain-linking? Why or why not?**

No comment.

**Question 12: Do you agree with our proposals relating to legacy arrangements? Why or why not?**

Yes, we agree with the proposals. However, with regards to with profits arrangement, clearly some way needs to be found to accommodate the impact of insurance company transfers and reorganisations. For example, transfers can result in regulatory capital being 'freed up' to be distributed to shareholders. This has the effect of reducing the amount of returns available for scheme members and undermines the prudential security of those insurance funds used by scheme members. If there has been a transfer then the impact on scheme members funds should be shown. This could be done by adding any amount released to shareholders to the total costs paid by policyholders and annualised over an appropriate period. Moreover, given that transfers can reduce the size of regulatory capital and weakening the security of a fund, then this should also be disclosed in the section on risks.

**Question 13: Do you agree with the proposed FLM disclosures and the use of own assumptions? Why or why not?**

We agree there should be forward looking metrics given the risk of decisions being unduly influenced by the use of past performance data.

But, we are very concerned with the proposal to give so much discretion to firms and trustees to determine their own methodologies and assumptions about future performance. The risks of this approach being abused surely does not need spelling out. Along with the intention to allow arrangements to emphasise past performance, this proposal on FLMs presents the greatest risk. The fact that the FCA/TPR is not proposing to require firms and trustees to disclose the assumptions behind their projections gives even more cause for concern.

There is no logical reason to allow individual arrangements to use different forward looking assumptions about specific asset classes within portfolios. That implies that the FCA/TPR believe that certain individual firms (and their investment managers/analysts) have superior abilities to predict the future investment performance of specific asset classes. As explained, there is no reason to allow the superior past performance of active investment managers to be used to predict future superior performance. Similarly, there is no reason to support the view that the same managers/analysts will be superior at predicting the future performance of specific asset classes.

If arrangements are allowed to select their own assumptions for specific asset classes, then it would mean that arrangements with similar asset allocations would be able to present potentially very different blended future returns.

The FCA/TPR rules out the use of standardised assumptions arguing that this creates the risk of herding. However, the bigger risk is certain arrangements pushing the boundary when selecting their own assumptions and the knock on effect on other arrangement. Arrangements will have an incentive to choose favourable assumptions in relation to asset classes to help with marketing and promotions. If certain arrangements push the boundary, then other more responsible arrangements will come under pressure to follow suit. This would cause herding at the upper range of forward looking assumptions, which is surely not a desirable outcome.

The FCA/TPR also argues that disclosure will act as a disciplining measure ensuring that projections are not unreasonable as outliers would be easily identified. In effect, this would create a form of herding - which the FCA/TPR seems to think would be a problem with standardised assumptions.

The FCA/TPR also rules out standardised assumptions on the grounds that it would be technically challenging to present the FLM figure on a net basis. We do not understand the logic of this. Using standardised assumptions is no more challenging than allowing arrangements to select their own assumptions. Indeed, it is probably less challenging.

The FCA/TPR could require firms to: use standardised assumptions for specific asset classes (determined by an expert independent panel and regularly reviewed); calculate a blended return depending on specific asset allocation; and then deduct all the actual charges

imposed on the scheme to calculate the expected net return. This would be best way to ensure a level playing field and prevent gaming.

Moreover, surely allowing arrangements to select their own assumptions is going to be more difficult for the FCA/TPR to monitor and supervise.

Even with the guardrails proposed, allowing own selection of assumptions cannot have the same benefits as standardised assumptions.

Overall, mandating the use of standardised assumptions would be the more straightforward and effective method, and clearly preferable to allowing arrangements to select their own assumptions.

**Question 14: Do you agree with the proposed requirement to obtain and consider external advice? Why or why not?**

**Question 15: Are the proposed guardrails sufficient to reduce the risk of gaming and ensure the FLMs disclosed are credible for use in the assessment process? If not, what alternatives/ additions would you propose?**

We have no objection to the proposal to obtain external advice. But, we do not see why this would necessarily have a positive impact for scheme members. Third party advisers are not in a better position to predict future performance than firms or trustees.

Of course, third party advisers could challenge the assumptions used to project returns. However, given that the FCA/TPR will not require firms and trustees to publish the assumptions or to publish the advice received with an explanation of why they have ignored the third party advice, then it is difficult to see how the use of third party advice would be effective at providing transparency and accountability.

So, these proposed guardrails are unlikely to be very effective at reducing gaming and promoting accountability.

Independent verification and published certification would provide some reassurance, as would requiring firms and trustees to publish assumptions and explanations. However, given that third party experts are likely to be recruited from a small community of experts whose revenues depend on how amenable their advice is to the client paying the fees, this alone is unlikely to be sufficient. As explained above, the most effective method would be to use standardised assumptions. This would be the most direct way to address the obvious conflict of interest.

**Question 16: Do you foresee any difficulties in reporting this data? If yes, what specifically?**

No comment.

**Question 17: Do you agree with our proposals for disclosing employer subsidies? Why or why not?**

We have no comment other than to reiterate that costs borne by employer and member should be disclosed.

**Question 18: We are aware that profit share and with-profits distribution can follow some time after the performance to which they relate. We have considered whether there would be benefit in apportionment, linking the share/ distribution to the period to which it relates. We would be interested in views on this.**

We have no comment on this other than to say that it would seem reasonable to link any distribution to the period to which it relates. We would also reiterate that with regards to insurance transfers, any distribution to shareholders should be treated as a cost borne by members – see above.

**Question 19: We would like to include ‘Payments out as retirement income’ as a key transaction. We are aware that some individuals approaching retirement may request payment at a future date, hence our request for data based on requests for immediate payment. We would be interested in views on whether our proposed measure above would provide a reasonable measure.**

No comment.

**Question 20: We would be interested in views on whether the payment of Pension Commencement Lump Sum should be a transaction included in this section.**

No comment.

**Question 21: Do you have any comments about our proposal to collect complaints data at the level at which the same service is experienced? Do you agree with our proposed definition of a platform?**

**Question 22: We would be interested in views on whether our proposed approach to negative perception metrics will provide relevant data to indicate saver concerns.**

We have no comments on this question other than to say we support the proposed metrics and to question why out of scope products are to be excluded. If an operator of an arrangement chooses to use out of scope products as part of the overall offer, then surely complaints relating to those products should be considered.

**Question 23: Does our revised approach to engagement metrics seem appropriate? Additionally, we would be grateful if you could provide us with an explanation of what surveys/data gathering exercises you currently undertake for member engagement. If you would be willing to share a copy of your member engagement survey(s) with us, please tell us.**

**Question 24: We welcome feedback on our revised proposals for engagement metrics and how that engagement generates specific outcomes.**

Regarding the survey, we have no comment other than to request that when the FCA/TPR are developing the survey, they should engage with civil society representatives not just the industry.

With regards to the engagement metrics, the percentage of savers who have nominated a beneficiary is a helpful metric. But, it is very limited in its ambition. We would expect to see metrics relating to members who are actively engaging with their scheme such as the percentage who regularly check their pension, and engage with the Money and Pensions Service (MAPS) PensionsWise and MoneyHelper services. This type of metric could be broken down according to member profiles such as by age, gender and so on to allow for better monitoring of engagement with pension issue.

**Question 25: Do you agree with our proposal for comparisons against a commercial market comparator group and the criteria for it? Why or why not?**

We agree with the idea of a commercial market comparator group. We fully support the idea of enabling scheme members (and their representatives such as trade union representatives) to compare value for money as measured by total costs and service quality metrics.

But, as mentioned, we have serious concerns about how past performance data will be used. It is important that in the interests of accountability and transparency scheme members should be able to compare past performance of their scheme against a relevant peer group and firms and relevant governance bodies be required to explain underperformance and justify historic decisions to use higher cost investment solutions such as active management which have acted as a drag on performance.

However, the FCA/TPR should ensure that firms should not be allowed to use past performance data against a comparator group as a tool for marketing and promoting services. To reiterate, it would be misleading to allow firms and advisers to imply that past performance is a guide to future performance.

Marketing and promotions data should be limited to comparative data on total costs (broken down by investment and service costs), quality of service metrics, and future projection based on standardised assumptions with total costs netted off.

**Question 26: Do you agree with our proposed approach to comparisons for different types of arrangements? Why or why not?**

Yes, we think that is a helpful categorisation.

**Question 27: Do you agree with the approach for weighting of BLMs and FLMs? Why or why not?**

**Question 28: Do you have any feedback on the proposed approach in option 1? What improvements or changes would you suggest?**

**Question 29: Do you agree with the proposal for the composite metric in option 2? Why or why not? Is it helpful for considering value? If so, is equal weighting appropriate for the composite metric or what alternatives would you suggest?**

**Question 30: Do you agree with the proposed composite comparison figure in option 2? If not, what do you think the composite metric or the FLMs should be compared against?**

**Question 31: Do you have any feedback on the proposed approach in option 2? What improvements or changes would you suggest?**

The FCA/TPR has clearly given much thought on how to disclose BLMs and FLMs. Unfortunately, we think the basic idea of giving past performance such a central role and conflating the use of BLMs and FLMs in any way, and therefore requiring weighting, is very risky. Therefore, we do not support either Option 1 or 2.

A BLM and FLM should serve different purposes. A BLM, including comparison of past performance and risks taken, should allow scheme members and representatives to hold firms and relevant governance bodies to account for delivering poor value for money. The purpose of an FLM should be to allow for judgment to be used to objectively evaluate the likelihood of an arrangement delivering future value for money.

Past performance is not a predictor of future performance. Therefore, allowing past performance in a BLM to influence the overall assessment of VFM in a composite VFM assessment would be misleading. Any FLM should be based on current total costs, a quality of service metric, and a projection of future performance based on known asset allocation and standardised assumptions set down by FCA/TPR.

To be clear, we do not challenge the need for investment firms and various intermediaries to report on past performance and risks taken in pursuit of an investment strategy. This is an important element of accountability. Investment managers and intermediaries should be required to justify poor past performance, risks taken, and the charges and costs involved. IGCs and trustees should be encouraged to demand lower charges and costs and switch providers where advantageous to drive value for the pension scheme members they represent. IGCs and trustees should be required to justify clearly to scheme members/

investors why they decided to use higher cost investment solutions when lower cost solutions such as passive strategies and funds are available.

We do support the collection and publication of performance data as an accountability tool. A database with performance and charges along with the name of the investment manager and adviser/ consultant should be published by the financial regulators.

The important point is that past performance should not be allowed to influence attitudes and beliefs about future performance and, therefore, the overall VFM of an arrangement. The critical point is that past performance must be **detached from** and not be allowed to influence forward looking VFM decisions. Costs and charges must be at the core of any VFM assessment.

It follows that any BLM and FLM should be compared separately to their own comparator group, not against a composite comparator group. Separating out BLMs and FLMs would also help deal with the issue of arrangements with a short track record. Of course, the arrangement would not have a BLM. But, the approach we advocate would allow for a forward looking assessment of VFM this would be based on standardised projections and current known charges.

**Question 32: Do you agree with the proposed guardrails? Do you believe other guardrails would be appropriate?**

We do not think the proposed guardrails will be sufficient to address the risks created by giving past performance such a central role in VFM assessments, and allowing BLMs and FLMs to be conflated.

It is unfortunate that, even though there is recognition of the very real risk of interested parties gaming the system, government pressure on the regulators to promote greater investment in certain types of assets is having a deleterious effect on the FCA/TPR proposals.

**Question 33: What is your preferred proposed approach to step 1: option 1 or 2? Why?**

**Question 34: Do you agree with the proposed use of FLMs in step 1, alongside BLMs? Or should FLMs be considered in a different way in the assessment process?**

As explained above, we think the most important point in Step 1 is ensure that past performance is detached from influencing expectations of future performance. BLMs and FLMs should be treated separately.

**Question 35: Do you agree with the proposed approach to considering service value in step 2? Why or why not?**

Yes, but this depends on how VFM on performance is calculated. Good past performance, which cannot be guaranteed to be repeated, should not be able to influence a rating in Step 1- see above.

**Question 36: Do you agree with the proposed approach to considering overall value in step 3 and rationalisation? Why or why not?**

Yes, but as above, it is important that past performance does not influence the rating at Step 1.

**Question 37: Do you agree with the proposed updated RAGG ratings? Why or why not?**

We do not understand why the FCA/TPR is proposing to move to a four part rating system. If the FCA/TPR wants to move away from a fairly simple, easy to understand 3 part traffic light system, then It would make sense to move to a 5 part rating system:

- dark red (must transfer)
- light red (action plan required, given 3 years to improve or else must transfer)
- amber (several areas for improvement, action plan required, under close monitoring by the regulators)
- light green (scores well generally)
- dark green (scores well across the board).

**Question 38: Overall, do you agree with the assessment process we have outlined above? Why or why not? What changes would you propose?**

We agree with the sequence of the assessment process. But, as explained above, we are very concerned about the emphasis given to past performance and the potential for past performance to influence overall ratings. Moreover, we would argue that much greater disclosure and transparency is needed to ensure accountability on VFM assessments. In the case of disagreements on ratings, IGCs should be given the final say on the rating, not the firm.

**Question 39: Do you agree with the proposed transfer requirements for red rated arrangements? Why or why not?**

In general, yes. But, as mentioned above, members should be given the right to appeal a decision to transfer to challenge the possible loss of potentially valuable benefits.

Moreover, we would argue that a 5 part rating system would be more useful. As well as the proposal to expedite transfers for dark red rated arrangements (with safeguards), the light

red category we propose would allow regulators to more closely monitor arrangements at serious risk of chronic underperformance.

**Question 40: Do you agree with the actions proposed for not value arrangements? Why or why not?**

Yes, but as above, we argue that a 5 part rating system would be more effective at providing accountability and driving performance improvements.

**Question 41: How should firms and trustees provide data to the central VFM database? E.g machine-readable flat file, file transfer, webform, direct API etc.**

**Question 42: Do you agree with our proposals for the central VFM database? Why or why not?**

We have no particular comment other than to say that the aim should be to provide data in a way that enables easy access by users, facilitated by searchable public access with links to the assessment reports.

**Question 43: When in the VFM cycle should VFM data be made publicly available and why? For example, should data be made publicly available in March or in October alongside assessments?**

The publication of the data should *not* wait until the publication of assessment reports. There is a risk that the contextualisation of reports by interested parties would allow poor performance to be downplayed. It would be preferable for data to be published as soon as possible to allow civil society and media to provide independent scrutiny.

**Question 44: Do you have any comments on the suggestion that firm/IGC or trustees should also add a link to the final VFM assessment report on to the proposed central VFM database?**

Yes, links should be provided.

**Question 45: We would welcome further comments on our proposals relating to the FCA Handbook.**

No comment.

**Question 46: Do you have any comments on our updated cost benefit analysis? A new CBA will be produced in the next consultation phase, incorporating further feedback and any substantive market or policy changes.**

We do not have the time or resources to critique the detail of the CBA. However, as will be clear from our response, we think the FCA is overstating the potential benefit of its

proposals and downplaying the potential distortions caused by allowing so much emphasis on past performance.

This marks the end of our submission.

**Financial Inclusion and Markets Centre (FIMC)**  
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