BlackRock

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VFM Policy Team
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Submitted via email to: vfmconsultationpaper@fca.org.uk

RE: CP24/16 The Value for Money Framework

BlackRock[1] is pleased to have the opportunity to respond to the Financial Conduct Authority (the "**FCA**") consultation on the Value for Money Framework.

BlackRock manages the pension savings of over 12 million people in the UK. Our investment approach is rooted in our fiduciary duty: we start with our client's objectives, we seek the best risk adjusted returns, and we underpin our work with research, data, and analytics.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of FCA on this and other topics.

Yours faithfully,

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[1] BlackRock is a leading provider of investment, advisory and risk management solutions, and has been active in the UK for over 50 years. Our purpose is to help more and more people experience financial well-being.

Executive Summary

BlackRock welcomes the work that the FCA, in conjunction with TPR and DWP, has done on the proposed VfM framework for DC pensions. As one of the largest managers of UK pensions savings, we are supportive of a common framework that helps to assess VfM. Indeed, this focus on value over costs is something we have consistently championed.

However, while we are very supportive of the policy intent behind this new framework, we believe there are a number of areas which need to be considered in order to ensure the framework delivers on its intention to drive value and address underperformance.

In particular, we are concerned that the focus on consistency and comparability within the framework may lead to sub-optimal outcomes for some members. Most notably, we would stress that capacity to tolerate risk will be different throughout the retirement journey and it is inappropriate to use the same risk metrics for all age cohorts, especially those at the beginning of their retirement journey.

Finally, we see a risk that this framework, rather than encouraging investment in private markets, may instead discourage this type of investment, given that higher costs will show up right away in the assessment, while enhanced performance can take some time to materialise and there is no forward-looking metric included in the framework.

Given the stated aim of encouraging schemes to think about long-term value, this seems to be an area where reconsideration is needed.

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Investment performance

Age cohorts

While we understand the rationale behind the proposed age cohorts in the CP (30, 5, 0 YTR), we would highlight that while most defaults target mid-sixties for retirement age, their investment strategies reflect the fact that people can and do retire from 55.

What this means in practice is that de-risking starts earlier than these age cohorts reflect and five years to retirement may be too late in someone's retirement journey to be useful. With this in mind, we would suggest that 30, 10, 0 YTR would be more appropriate.

Risk metrics

We agree with the point made in the CP regarding the need to ensure that disclosure of investment returns does not incentivize excessive risk taking and so support the inclusion of risk adjusted metrics in the framework.

In our view there are three factors that are most important when thinking about performance – whether the product's return objective was met (was the fund "true to label"?); whether the asset allocation was suitable for the relevant cohort of members (are 25-year-old members in inappropriate defensive products?); and whether the product's risk profile was appropriate in achieving the return for that cohort (ensure funds are not taking excessive risk or practicing excessive prudence).

In line with this, we would stress that capacity to tolerate risk will be different throughout the retirement journey and it is inappropriate to use a single risk measure for all age cohorts, especially those at the beginning of their retirement journey. Since investors in the growth phase have time to recover any losses, for them the time to recovery is arguably a more important measure of risk than Annualised Standard Deviation (ASD) or Maximum Drawdown. At the point at which a scheme moves into a glide path/de-risking phase, capital volatility and drawdown become more appropriate risk measures of the investment strategy.

With this in mind, we would suggest that these risk measures are removed or minimised for the 30 YTR cohort. Otherwise, there is a risk of nudging schemes into inappropriately cautious investment strategies for younger cohorts, when the focus should be on maximizing returns.

Chain linking

We agree with the general proposal for chain-linking where it reflects the historic member experience, thus providing accountability for past investment decisions. However, it makes most sense to apply this to cohort-based returns, which reflect the performance experienced by members. If applied to the current proposal of age-based returns, we do not see what value chain-linking provides, since it will not be reflective of any member's experience.

Forward looking metrics

We have previously stated our support for the inclusion of forward-looking investment performance metrics since they can help provide insight into the thinking that drives asset allocation decisions, particularly where changes are made to investment strategies.

Combined with the past performance data, investment performance projections show how a scheme's return expectations compare against what has been delivered, providing a further measure of accountability. This same comparison repeated over time will allow commentators to assess whether a scheme's return assumptions are consistently over-optimistic, thus reducing any incentive to over-inflate expected returns.

Failure to include some form of forward-looking investment performance could potentially encourage risk aversion in investment decisions as the potential returns from their investments will not be reflected in the VfM calculation. This is most important in relation to private markets where management fees are higher. Given Government and firms' ambition to increase portfolio weighting towards illiquid and unlisted markets, the decision not to include forward-looking metrics feels counterintuitive.

We are of course cognisant of the points raised in the CP around the potential to 'game the system' by inflating expected returns. One possible solution may be for funds to have a benchmark, perhaps from central Capital Markets Assumptions, for expected returns for each asset class. That way, projected returns for a given default could be calculated on a more consistent basis, depending on their asset allocation, and if their investment strategy included a higher weighting to private markets and 'productive' assets, this would be reflected.

Asset allocation

Proposed disclosures

We are supportive of the requirement to disclose default strategy asset allocation alongside the performance numbers and believe this will bring further transparency to the ecosystem. Asset allocation decisions are a key driver of returns and so the two pieces of information should be shown together to aid the assessment of value of a scheme's investment strategy.

While we are mindful of the reporting burden being placed on industry by this framework, we would suggest that there are two areas whereby we believe the asset allocation disclosures could be improved:

- On bonds, for the disclosure of allocation to different types of bonds to be meaningful, it must include duration.
- Given it is a dominant risk factor, we do not believe that disclosure of % £ hedged should be optional.

Assessment and outcomes

Market-wide comparisons

As we stressed in our response to the last consultation on the VfM framework, given the diversity in investment objectives and the investment budgets allocated to delivering those objectives, our view is that blunt market-wide comparisons and benchmarks are unlikely to drive the desired behaviours.

The member return will differ because schemes have different overall cost bases and follow different investment strategies whose objectives, associated asset allocation and cost are different. Simply comparing one set of returns to another does not allow a judgement to be made that a better performing scheme delivers better value to one that performs worse.

Additionally, while the framework has the intention to nudge schemes to boost their investment budgets and broaden portfolio diversification, it is not clear how the RAG process would treat investment strategies that increase cost to boost performance in the long-term.

For private asset classes for example, higher costs will show up right away in the assessment, while enhanced performance can take some time to materialise and at the moment there is no forward-looking metric included in the framework. If such decisions result in amber or red ratings, we do not see what incentive providers have to make them in the first place. Particularly when the consequences of a red or amber rating are commercially negative.

Rather than seeking to drive market-wide comparisons, regulators should instead encourage schemes to assess their investment performance against investible benchmarks that are appropriate to the scheme’s own strategy. By this we mean moving away from assessing the performance of default strategies solely against member-driven objectives such as CPI+X, towards the assessment of performance against benchmarks that can be invested in and have a tracking error, such as a simple market index-related benchmark (or a composite where the investment strategy is multi-asset).

Support for employers

Given the role of Employee Benefit Consultants (EBCs) in helping employers to choose a suitable pension scheme for their employees, for the VfM framework to be successful there is a need to ensure consultants take it into account when advising employers through some form of duty or industry commitment.

We would also note that alongside this, there is a need for further guidance for employers. The current TPR guidance only refers to costs and how they are structured, the type of tax relief used by the scheme, additional services offered by the Master Trust or provider, such as writing to members, and whether it fits with the payroll systems they use. This does not give sufficient support to employers who are unfamiliar with the pension landscape and will not drive the outcomes the Government is looking to see in this segment.