Annex F – FCA cost benefit analysis

Executive summary

1. This annex presents the third-stage cost benefit analysis (CBA) for the proposed Value for Money (VFM) Framework, developed jointly by FCA, The Pensions Regulator (TPR), and the Department for Work and Pensions (DWP). The Framework aims to improve outcomes for savers in default workplace defined contribution (DC) pension schemes by promoting competition, increasing transparency, and standardising assessments of value. It does this by mandating the publishing of information to ensure consistent, objective, and transparent assessments of value across DC schemes.

2. The DC workplace pensions market is significant, with around £664bn of assets and 21.7m active savers. Over two-thirds of these savers are in default pension schemes and stand to benefit significantly from improvements in performance. We anticipate that these improvements in performance will be focused on underperforming schemes "closing the gap" with average performers, rather than a market-wide increase.

3. This CBA focuses on the FCA-regulated market only and follows on from two previous consultations (CP24/16 and CP26/1) and DWP's impact assessment, which also considers non-FCA regulated schemes. We build on the previous analysis and feedback from stakeholders, and update our cost and benefit calculation with updated data from a new data request to firms in the market.

4. Over 10 years we estimate total costs to industry of £57.2-159m, with benefits to savers of between £0.6-1.7bn, leading to a positive Net Present Value (NPV) of between £0.5-1.6bn. Costs are largely expected to be incurred by firms in implementing and maintaining the framework while benefits are expected to accrue to savers through increased performance from currently underperforming schemes.

Introduction

5. The Financial Services and Markets Act 2000 requires us to publish a CBA of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.

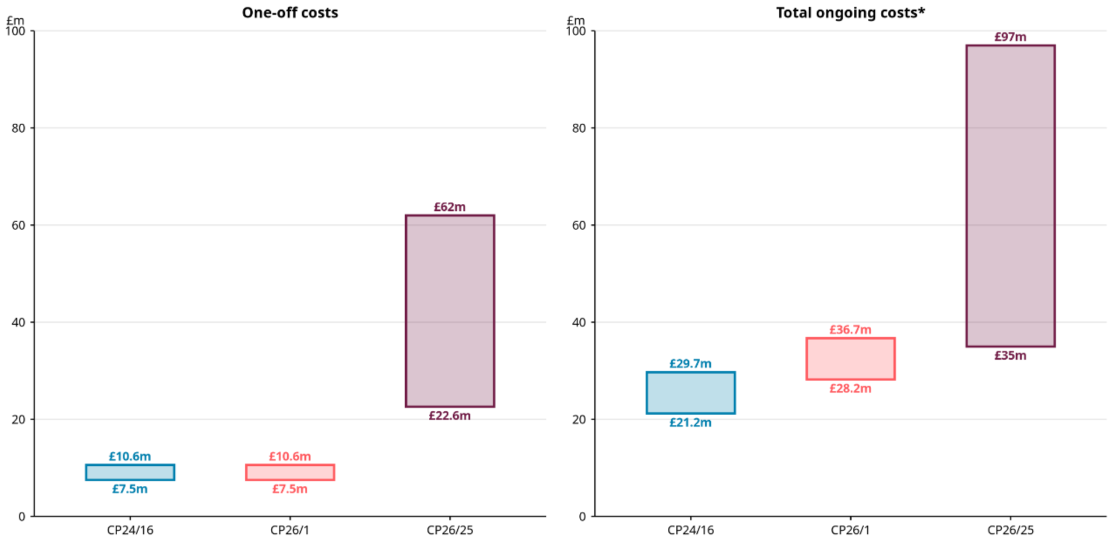
6. This analysis presents estimates of the significant impacts of our proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide a qualitative explanation of their impacts. Our proposals are based on weighing up all the impacts we expect and reaching a judgement about the appropriate level of regulatory intervention.

7. This CBA is the final in a three-stage process which sets out detailed rules and for the new VFM Framework jointly designed between FCA, TPR, and DWP. VFM is designed for savers invested in default arrangements of workplace pension schemes. It follows CP24/16, published in August 2024, DWP's impact assessment, and

CP26/1, published in January this year. Table 1 in the Options section below summarises how the policy proposals have changed across the 3 consultation stages.

8. Figure 1 shows how our estimates of firm costs have changed across the 3 consultation stages. Each bar shows our estimate at that stage of the consultation, based on the information available at the time. As the proposals have become more detailed, firms have updated their estimates of the costs they expect to incur. The estimates should therefore be read as independent, successive estimates, not cumulative costs across consultations. Our estimates of one-off and ongoing costs are higher in this CBA, reflecting the updated cost survey and the more detailed specification of the proposals at this stage. Our benefit estimates are unchanged and remain set out in the benefits section and summary tables.

Figure 1: Firm costs (one-off and ongoing) by consultation, NPV



Note: Each bar shows the estimated cost by consultation and is not additive to estimates from earlier consultations. Bar height shows the lower and upper bound of the uncertainty range. Ongoing costs are shown as the NPV over the 10-year appraisal period.
Source: FCA analysis

9. Our proposals aim to drive competition within the workplace pension markets, to increase returns and ultimately improve outcomes for savers. This includes publishing comparative assessments of schemes to clearly identify poor performance and to improve competition based on the value of schemes to savers.

10. In phase 2, we committed to a full remodel of implementation and ongoing costs to firms following industry feedback that we had underestimated the impact to firms. To address these concerns, we have issued an updated cost survey to firms to underpin our analysis.

Feedback to CP26/1

11. We received 93 responses to the CP26/1 from stakeholders, of which 10 provided comments on the CBA. Some respondents felt that costs had been underestimated. We have addressed this concern by requesting updated cost information from firms now that the proposals are largely settled.

12. Some respondents suggested that benefits may be overstated or take longer to materialise. It is difficult to accurately assess changes in performance, so we have

also included a breakeven analysis, at which point our proposals will deliver a net benefit. Based on the costs estimated below we expect benefits per policy of £2.89-8.03 being required over a 10-year period for our proposals to break even.

13. Some respondents to our previous consultations suggested we consider the impact of a market downturn and other risks. Given we are concerned with the gaps in performance between schemes, we expect that our proposals will still generate positive outcomes in these scenarios as the gap will continue to close, so we have chosen not to estimate the impact of a downturn.

The Market

14. The commercial DC workplace pensions market is made up of both contract-based and trust-based schemes. However, for the purposes of this CBA, unless otherwise stated, where we refer to 'the market' we are referring to only contract-based workplace DC pension schemes[1]. These schemes are regulated by the FCA. The proposals in this consultation will apply to all default and quasi-default arrangements of contract-based workplace DC pension schemes in accumulation.

15. Independent Governance Committees (IGCs) and Governance Advisory Arrangements (GAAs) were introduced under FCA rules in April 2015 following the Office of Fair Trading's 2013 market study of the workplace pensions market, which identified competition concerns and weaknesses in governance and consumer engagement. For this CBA, we refer to IGCs and GAAs collectively as IGCs. They provide independent oversight of workplace personal pensions in accumulation, and investment pathway solutions in drawdown. IGCs have a duty to scrutinise the value for money of the firm's workplace personal pension schemes on behalf of scheme members. However, it is currently difficult for IGCs to compare performance and quality of services provided on a consistent basis and across the market even with third party data provision.

16. Figure 2 sets out the key information for the market for UK DC workplace pensions.

17. We will shortly be publishing a market note which provides more detail on the economic context of the UK pensions market. Therefore, we are not repeating that information in the CBA.

[1] For a consideration of non-FCA regulated schemes, please consult DWP's impact assessment.

Figure 2: The UK Defined Contribution Pensions market

Scope

VFM will apply to all default and quasi-default defined contribution workplace pensions in the UK. This CBA only considers the costs and benefits of FCA-regulated contract-based pensions.

Total assets – £737bn[1,6]
Total members – over 30m[2]

FCA-regulated

Contract-based
Total assets **£422bn**[6]
Total members **8.2m**[4]
Active members **4m**[5]
Policyholders **20m**[6]

64% of members invested in default arrangements[4]

21 group personal pension providers

TPR-regulated

Trust-based
Total assets **£315bn**[1]
Total members **29m**[4]
Active members **9m**[5]

73% of members invested in default arrangements[4]

33 master trusts
24,720 schemes
790 non-micro schemes[3]

Market participants

Most contract-based workplace pension schemes are provided by large insurance firms and other providers.

Savers
Employees and former employees with workplace pension schemes

Employers
Responsible for setting up workplace pension schemes

Pension scheme providers
Offer default schemes to employers for their employees

Corporate advisers
Help employers select and design default investment strategies

Independent Governance Committees (IGCs)
Provide independent oversight of workplace pensions in accumulation to ensure they are delivering VFM

Glossary

Total members
All employees enrolled in a workplace pension

Active members
Employees currently contributing to a workplace pension

Default arrangements
Arrangements that members automatically join

Sources:
1. Pension Policy Institute (2025) – Pension scheme assets
2. ONS (2026) – Funded occupational pension schemes in the UK
3. TPR (2026) – Occupational defined contribution landscape in the UK 2025
4. Pension Policy Institute (2025) – The DC Future Book
5. Annual Survey of Household Earnings (2024) – ONS
6. FCA survey data

Note: FCA survey data is from 2026. Contract-based assets are based on 2026 data, while trust-based assets are estimated using September 2024 data.

Problem and rationale for intervention

18. The current market for workplace pensions in accumulation does not always deliver the best value to savers. This arises from information asymmetries and the principal agent-problem delivering weak competition among workplace pension providers. We set out the mechanisms below in Figure 3.

Drivers of harm

19. Harms in the market are driven by:

- **Information asymmetries -** Limited transparency around the performance of complex pension products can make it difficult for employers and IGCs to access the information needed to inform decision making and compare value being delivered. Current regulatory requirements do not provide IGC's with sufficient information to be able to make cross-market comparisons when assessing the value of their scheme.
  - The FCA's Thematic Review (TR20/1) found that IGCs were often lacking information to complete their analysis.
  - The same review noted the difficulties in obtaining information from firms further down the investment chain.
- **Principal-agent problem -** the absence of significant saver engagement or ability of savers to directly influence firm performance means employees are dependent on their employer and IGC to do so on their behalf. Whilst the employer faces limited incentive to ensure the pension is high performing but a high administrative burden from switching providers.
  - The Pension Policy Institute found that at least two-thirds of savers remain in default funds, which may not be optimal.
  - DWP's employer survey found that value for members was only the fourth most considered factor by employers offering DC schemes, fees or costs to the employer was third, and ease or convenience was most important.

Transmission of harm

20. **Weak competition** – The above drivers of harm lead to insufficient competitive pressures on scheme providers as savers cannot effectively switch or threaten to switch from underperforming schemes.

- Only 13% of employers offering DC schemes have switched provider or thought about switching provider (DWP, 2024),
- Almost half of employers who had not switched provider indicated they would not consider switching.

The Harm

21. Together, these factors lead to a significant divergence in outcomes for savers in default schemes across all 3 metrics driving value: performance, costs and charges, and service quality. This results in smaller pots and poor service for consumers in underperforming schemes.

Smaller pots

22. When a consumer is in a default scheme that is underperforming, they face a smaller pot in retirement. If the scheme is underperforming on a net basis, this may be because of either investment decisions and asset allocation, or from costs and charges.

23. Government analysis suggests that over a five-year period, a DC pot of £10,000 (with no further contributions) invested into the lowest performing scheme would be worth £10,400, whereas if invested in the highest performing scheme it would be worth £15,100, which is 46% higher.

24. In our 2024 firm survey, we asked firms for the AUM-weighted average performance of firms' in-scope schemes. We found that there could be a performance gap of £1.5bn between underperforming firms and the market average (see *benefits to savers* for more information), uprating this gap to the increased market size leads to a gap of £1.8bn. This is a considerable sum of money that could be providing better outcomes for consumers, particularly when considering the opportunity to compound over the 30+ years a consumer may be saving. However, there are also risks: past performance may not be replicated in the future and firms may "herd" towards a benchmark comparator, leading to worse performance.

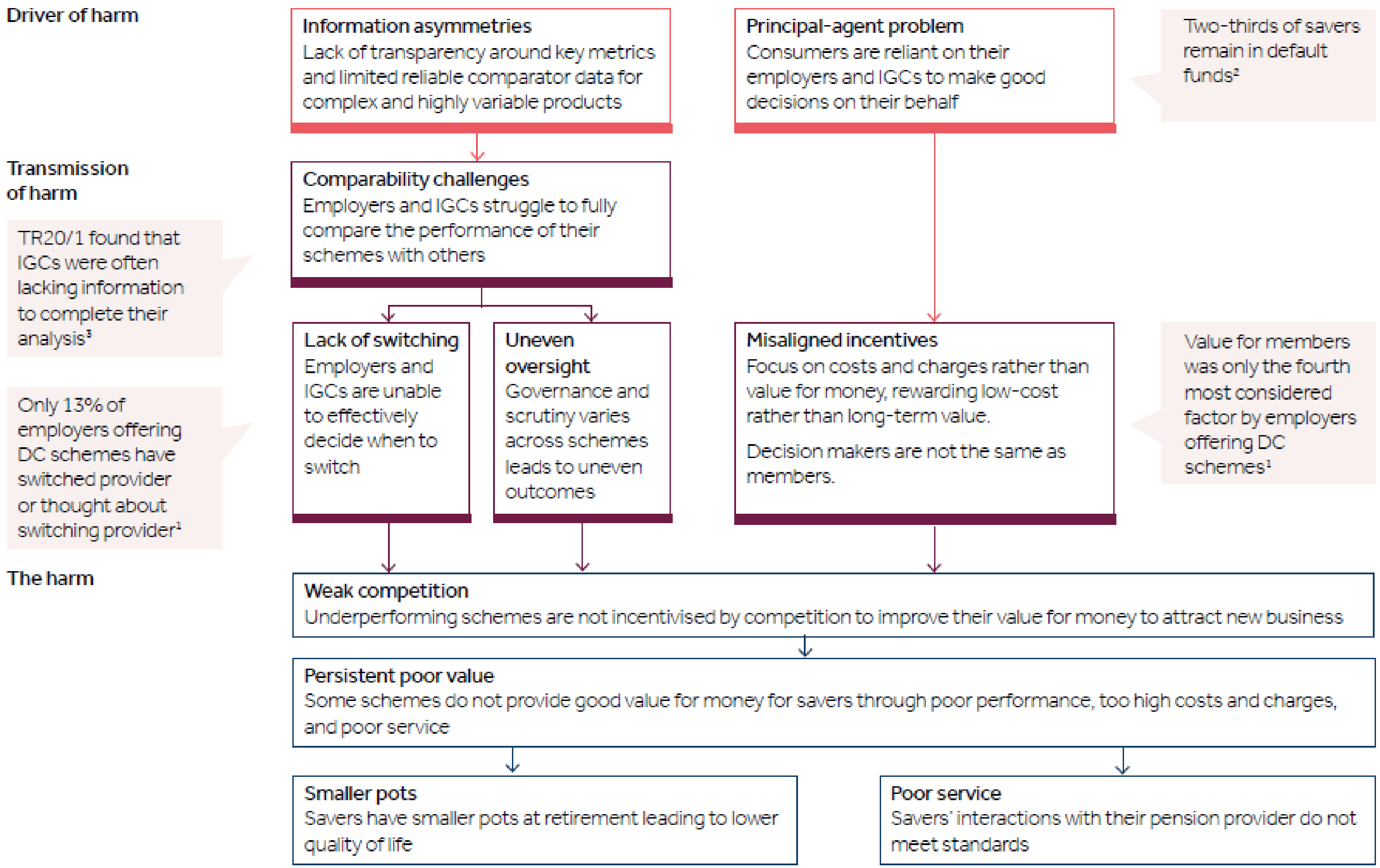
25. Underperformance can lead to significantly worse outcomes for consumers in retirement, leading to a lower quality of life as they do not have sufficient capital to support their desired lifestyle.

Poor service

26. Pension schemes provide important services to their savers, both in ensuring transactions are completed promptly and accurately, and in supporting their journey to retirement. Where some consumers do not receive a high quality of service, they may face stress and delays in their requests, leading to opportunity costs and reductions in wellbeing over the long term.

27. In the 12 months to May 2024, 1.5% of adults with a DC pension in accumulation said they experienced poor customer service, the second-most common problem for consumers with a DC pension in accumulation after complex product information. Of those consumers who said they experienced any problem with their pension, 15% said that because of the problem they suffered stress and 12% spent significant time resolving the problem (Financial Lives survey, 2024).

Figure 3: Rationale for intervention



Sources
1. DWP (2024) – DWP employer survey
2. Pension Policy Institute (2025) – The DC Future Book
3. FCA (2020) – TR20/1: The effectiveness of Independent Governance Committees and Governance Advisory Arrangements

Options

28. These proposals have been developed and agreed jointly with DWP and TPR after carefully considering the differing views and alternative options, including detailed consultation with industry working groups Therefore, non-regulatory options were not available. Within this we have considered options for delivery to ensure we take the most proportionate approach in delivering the VFM framework.

29. We have previously consulted twice on VFM proposals which have since developed following feedback from stakeholders. In phase 1, we estimated total costs to firms of £29-40m from implementing and maintaining metrics for the VFM framework, and benefits of £430m-1.2bn from a reduction in the gap between underperforming and average schemes. The key proposals that we decided against at that stage were listed in the previous CBA. These were Forward Looking Metrics (FLM), a central repository for data storage, and regulator-set benchmarks, as used currently in Australia for superannuation funds. Based on feedback to the previous consultation we are still not proposing regulator-set benchmarks. We maintained many of our proposals on backwards-looking metrics.

30. In phase 2, we updated our proposals to include FLMs and made some adjustments in response to feedback that we largely anticipated would reduce burden on firms. We did not seek to re-estimate costs at this stage given we would be consulting for a third time shortly after and did not want to add to firm burden. Overall, we have significantly reduced the number of metrics over the process.

31. We set out the alternative policy options considered and our analysis of each option in Table 1. We do not consider these options sufficiently address the harms identified.

Table 1: Alternative policy options considered

Issue	Why we are doing this	Policy choice in CP24/16	Changes to policy in CP26/1	Proposals in CP26/25
1. Scope				
Overall approach	The pension market is large and diverse, and value matters across all products. However, in the interests of proportionality we are proposing to limit the scope of the VFM framework at this initial stage to those schemes and arrangements that are most material to savers.	• We focused on workplace pensions in accumulation in the first instance: 16 million people now save into DC schemes. We needed to strike a balance between targeting schemes where savers face the greatest risks and implementing a framework that is workable. • We proposed that disclosures are made for all default and quasi- default arrangements: over 90% of workplace pension savers are invested in their scheme's default arrangement. • We proposed to exclude at this stage arrangements with fewer than 1,000 members (unless all arrangements in a scheme have fewer than 1,000 members, in which case the largest is in scope) with proportionality in mind.	• We aim to clarify the definition of quasi-default funds. • Decisions about initial / future scope are being considered. • A position is being clarified in relation to with profits funds.	• We are proposing a phased approach to the implementation of VFM whereby some arrangements will not need to undertake an assessment in Year1 (but will still be required to gather data). • In the first year of operation data will only be required for the second six months of the year. • We are proposing a refinement of in scope definitions in relation to more complex arrangements such as Collective DC (CDC) and AVCs. • We are proposing an amendment to prevent very small employers causing an arrangement to be mis-classified as quasi-default. • We are clarifying a number of definitions.
2. Investment performance				
Overall approach	Investment performance is key to delivery of long-term consumer outcomes. It is thus essential to capture investment performance.	• See below.	• See below.	• Removal of need to consider the 5YTR cohort.
Include backward looking returns	Backward looking metrics are an accepted way to measure performance and widely calculated. They have some limitations as they are not a guide to the future.	• We proposed disclosure of gross investment performance. • We proposed disclosure of performance net of investment charges to allow comparison of the value of the investment element. • We also proposed disclosure of investment performance of net of all costs and charges as this would aid comparison of overall value delivered by arrangements.	• Minor changes to the data disclosure requirements for assessment purposes. • Simplification of rules on chainlinking and unbundling.	• We are considering proposing a different method of calculating backward looking performance. This would be instead of arithmetic or geometric averaging. • We are considering further revisions to chainlinking.
	We want to drive long-term thinking, so we are selecting metrics over a time period but recognise it is not appropriate or possible to retro engineer decades of data.	• We proposed disclosure of 1, 3, and 5-year periods where the data is available. We recognised that data for 10 and 15 may not always be readily available. In future, schemes should be able to report on more historic returns. • We proposed chain-linking for the periods of 1, 3, and 5 years back (10 and 15 where reasonably practical to obtain) recognising that historic data is not always easily obtainable.	• Removed the need for year 15 disclosure. • Chainlinking has been simplified to exclude internal transfers to arrangements with an existing history. • We have moved from a geometric basis to arithmetic. This should have minimal impact on production costs.	• We have proposed further revisions to the calculation methodology and chain linking.

Issue	Why we are doing this	Policy choice in CP24/16	Changes to policy in CP26/1	Proposals in CP26/25
Asset allocations	Understanding asset allocation is important to provide context to performance and understand drivers of performance. Standardising asset allocation disclosures and making them public will enable greater transparency across the industry.	• We assessed that full asset allocation disclosure would not be proportionate. Instead, we proposed requiring the disclosure of asset allocations mirroring current policy regulations against 8 key asset classes. We also proposed adopting the same definitions as DWP's statutory guidance, with the appropriate adjustments. In addition, we proposed requiring the disclosure of several sub-asset classes to promote further transparency.	• A separate pilot of asset allocation proposals is planned. • No changes to the data collected at this stage.	• We are providing additional definitions and clarifications.
Forward looking metric	Past returns are factual and reflect member experience. However, there would also be value in having a forward-looking perspective to supplement data on past returns.	• Not proposed due to the complexities and gaming risks.	• All arrangements will be required to disclose a projected return and risk, based on own assumptions. • Firms must also obtain and consider third party advice on assumptions used for their FLMs. • FLMs will be used in the assessment process.	• We are removing the requirement to obtain and consider third party advice. • Firms must instead disclose the assumptions that the FLMs are based on.
3. Costs and charges				
Inclusion of costs and charges within the framework – overall approach	Value in delivering performance and quality of service is dependent upon the costs and charges incurred in doing so.	• See below.	• Minor change to cost / charge disclosure to remove need to separate out investment / service costs for years other than year 1. • Move from geometric to arithmetic mean to match investment performance.	• Proposed revisions to calculation methodology including simplification for arrangements without complex charging structures.
Bundled schemes and combination charges	Investment charges and administration charges are different in nature and drive different outcomes. Investment costs should be expected correlate to investment choices and performance. Administration costs may cover baseline administration only or may relate to more value-add activities also.	• We proposed unbundling costs to facilitate a better understanding of whether costs link to value generated. • Recognising that unbundled data may not be readily available nor consistent, and not seeking to create undue processes for obtaining such data, we proposed an approach to estimate unbundled costs	• Maintaining need to unbundle but relaxing the way in which this is calculated.	• Proposed revisions to calculation methodology for arrangements with combination and complex charging structures, the latter impacts trust-based arrangements only at this stage. Two options presented to alleviate concerns raised.
4. Quality of services				
Inclusion of services within the framework – overall approach	Quality of service is in itself of value to savers and can support informed decision making and therefore outcomes.	• See below.	• See below.	• See below
Scheme administration	We expect schemes to carry out key financial transactions promptly and to maintain a baseline of data about their scheme and scheme members. Efficiency of scheme administration will likely be a main way that scheme savers judge the quality of service that a scheme provides.	• We proposed scheme administration metrics that have a material impact on saver outcomes focused on the promptness and accuracy of transactions and the quality of record keeping.	• We have refined these and removed some of the previous metrics we consulted on.	• We propose further clarifications and minor amendments to definitions but no significant changes.
Member communications	Members who engage positively with their scheme have the best chance of optimising their contribution levels and choosing a strategy that best meets their needs.	• Engagement with workplace pensions is low. We therefore suggested quantifiable metrics that may act as measures of engagement.	• We have reduced the number of metrics significantly based on responses to our CP and engagement with industry. • Firms will now be required to provide a single metric which focuses on the	• No significant changes proposed.

Issue	Why we are doing this	Policy choice in CP24/16	Changes to policy in CP26/1	Proposals in CP26/25
		• We also proposed that an event- based member satisfaction survey be conducted to understand savers' experience.	percentage of savers who have nominated a beneficiary.	
5. Assessment and outcomes				

Assessment process	Assessments currently allow for considerable flexibility in how VFM is assessed by IGCs. The framework aims to provide a more consistent and objective assessment that makes use of published framework data.	• We proposed a mandatory process for assessing VFM which promotes objectivity in and between assessments whilst allowing scheme demographics to be considered.
		• IGCs were required to consider the framework metrics taking account of costs and charges at each step to focus on value delivered.
			• Assessment process streamlined from 4 Steps to 3 Steps.
			• Comparisons against commercial market averages complied by central VFM data base, rather than against 3 chosen comparators.
			• A presumption of not value to be introduced to investment performance metrics for YTR cohorts.
			• FLM metrics to be used in assessment process, two options are being consulted on.
				• Further streamlining of assessment process proposed:
				  • Removal of assessment for the 5 YTR cohort.
				  • Update to the commercial market comparator group for the 0 YTR cohort to take into account decumulation aims.
				  • Moving forward with option 1 from CP26/1 for considering FLMs in Step 1.
				• Simplification of the assessment process by removing consideration of multi-employer cohorts (for year 1 of implementation at least).
				  • Only require assessments in year 1 for some arrangements (phasing),

RAG rating	A VFM assessment should provide a simple, clear and transparent result.	• We proposed that arrangements are rated Red, Amber or Green as a simplified and identifiable assessment of value.	• Updated rating system to four ratings – addition of light green rating.	• Further clarifications to distinguished between light and dark green
6. Disclosure				
Publication of data	In order to compare VFM assessment data with other arrangements data needs to be published and accessible. This also increases transparency allowing savers to view the performance of arrangements.	• We proposed that data be made available in a suitable format on a publicly accessible website.	• We are now proposing a centralised VFM database where information can be accessed.	• No significant changes proposed

Our proposed intervention

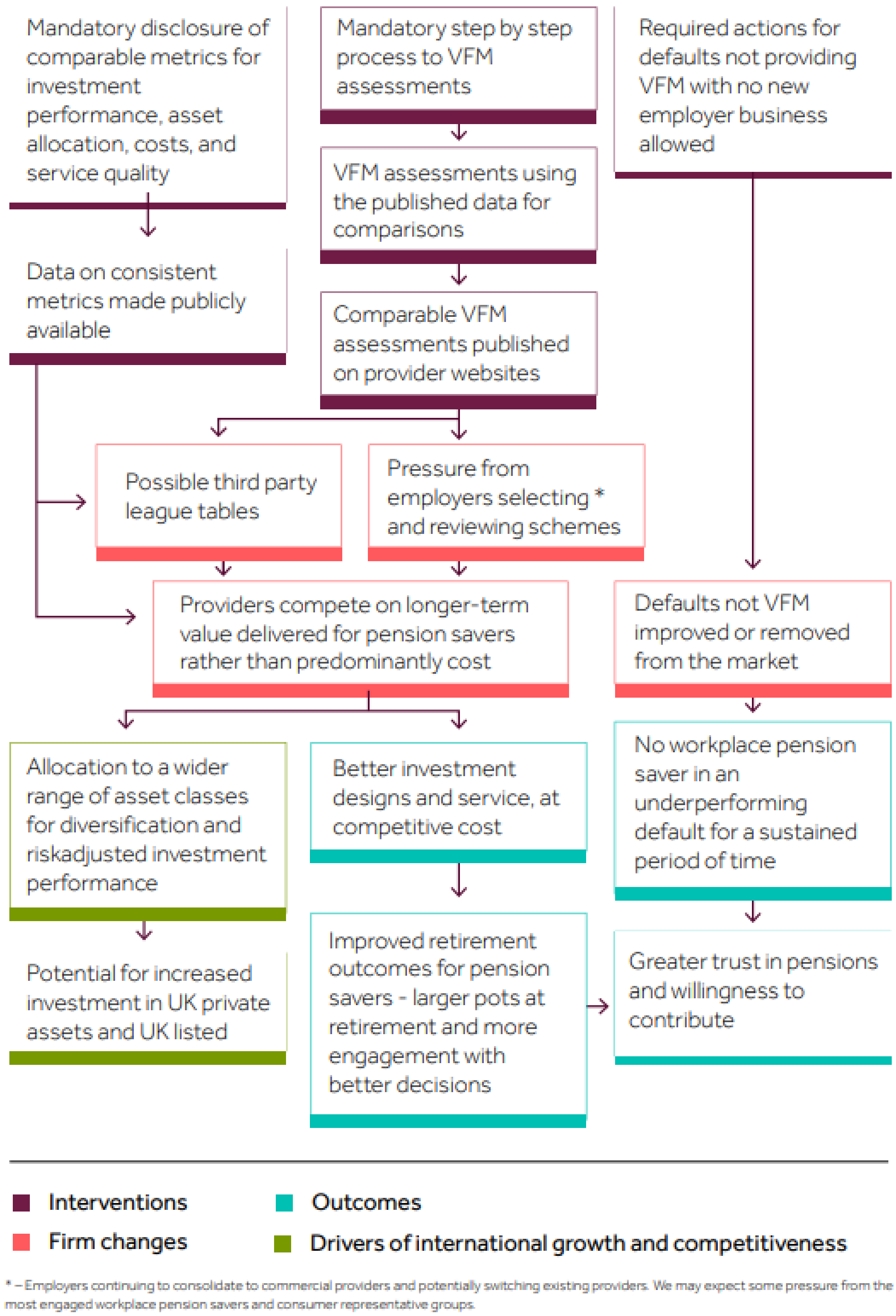
32. The VFM Framework has been developed to support a consistent and objective process for assessing VFM across DC schemes. It provides a transparent, standardised way for IGCs to holistically assess and evidence VFM outcomes. The Framework requires specific actions of firms to demonstrate they are trying to improve the value they provide to savers.

33. The intervention will consist of four elements that aim to deliver savers overall larger pots at retirement (for further policy details, please refer to the main chapters in the Consultation Paper):

    - Mandatory disclosure of comparable metrics will ensure that there is consistent and comparable data published publicly on firms’ websites, which will incentivise underperforming firms to improve their performance.
    - Comparative assessment will require IGC’s to adopt a more objective approach to assessing VFM which will be compared to other providers.
    - We expect mandatory publication of assessment results to further incentivise firms to improve performance and encourage employers to review and consider switching providers where necessary.
    - Specified actions for firms with in-scope arrangements that are assessed as not providing VFM includes informing the employer.

34. The causal chain sets out how we expect our proposed intervention will reduce the harm set out above.

Figure 4: The causal chain



Baseline and key assumptions

35. Our baseline for this CBA is the current rules and regulatory environment followed by firms, including establishing effective IGCs. While CP26/1 used CP24/16 as its baseline, this CBA considers the impact of only the final set of VFM proposals as the full intervention. It does not account for the costs and benefits set out in previous

CBAs. This is because firstly, we do not expect firms to have begun work in implementing any earlier set of proposals, and secondly, it is difficult for firms to provide differences in estimates based on proposals they have not implemented.

36. We currently require IGCs to assess the value for money that a firm provides, with the assessment embedded in FCA rules for a firm's obligations under the Consumer Duty. Standards and capabilities differ between IGCs and this is exacerbated by informational asymmetries and lack of access to data. We assume that the VFM framework will reduce these information asymmetries and enable IGCs to better fulfil their duty to deliver value to consumers, thus reducing the principal-agent problem. We do not expect that existing market mechanisms will address these issues as IGCs will continue to lack the information to effectively perform their function.

37. In the absence of our proposals, we expect that pension schemes would continue to perform at their current levels into the future and the differences in performance would remain. Future performance is highly uncertain, but we consider that the consistent underperformance exhibited by some pension schemes would continue and remain unremedied.

The Pensions Schemes Act 2026

38. VFM is just one of a number of proposals included in the government's Pensions Schemes Act 2026 that will fundamentally impact the workplace DC pensions market. DWP have published an Impact Assessment, including on VFM, for these changes – considering impacts across both contract- and trust-based schemes. The changes may lead to some consolidation amongst contract-based schemes as multi-employer DC workplace pension schemes will be required to have at least one default arrangement with £25bn AUM by 2030.

39. DWP estimated total costs across both contract- and trust-based DC schemes of £340-471m and benefits of £6.6-30bn. Most costs are associated with trust-based schemes due to the number of providers, while benefits are more evenly distributed due to the similar AUM of the sectors. In CP26/1 we presented the government's benefit modelling for only contract-based schemes, finding an estimated benefit of £10bn. This is significantly higher than our estimated benefits, due to different approaches in modelling. We restate our reasoning for maintaining our approach below.

40. We have assessed that the modelling used in the original CBA is more appropriate to this half of the market because of the smaller number of firms in the market. The approach in the Impact Assessment, assuming a 0.4% annual return improvement, is based on the overall market (which contains the trust-based market) where consolidation of schemes are expected to drive measurable performance gains across the market.

41. For the contract-based DC market, it was more appropriate to assess benefits through the lens of improved governance, transparency, and competitive pressure rather than modelling specific investment return uplifts as in the Impact Assessment. This is because the key mechanism is not forced transfers but the empowerment of IGCs and market participants to challenge firms and shift behaviours, which should improve the performance of low performing funds but not cause improvements for funds that are already highly performing.

42. For this reason, we will focus on modelling using market-specific benefits, rather than applying assumptions about uniform return uplifts that may not translate directly to this part of the pensions landscape.

43. However, the modelling used by the government does still include the contract-based DC market, and we therefore consider it an upper bound in a secondary scenario.

<u>Firms</u>

44. We expect our proposals to impact all 21 firms offering contract-based DC pensions to employers, collectively managing around £422bn of assets within their schemes.

<u>Data</u>

45. We issued a firm survey to all 21 firms who would be in scope of the proposals, receiving 9 responses. These firms represented £350bn (83%) of AUA and 15.9 million policyholders, with over 600 default arrangements. Of the 9 firms that submitted data, 6 provided cost and investment performance information.

46. We asked firms to estimate the one-off and ongoing implementation costs related to our proposals. In our previous data request to firms, accompanying CP24/16, we noted that firms reported inconsistent costs due to difficulty in estimating costs related to uncertain policy. Given the two subsequent consultations, we believed that firms will have sufficient information to estimate implementation costs. However, firms continued to note the difficulty in providing cost estimates before final policy is announced. Nevertheless, we assume that the data provided is accurate and representative.

47. In addition to the information on costs, we also asked two questions regarding gross and net annualised investment performance and annual management charges. We asked that these were provided on an AUM-weighted basis for the in-scope schemes they operate. For the purposes of our benefit analysis, we assume firm responses are representative of that firm's arrangements.

48. We received substantially fewer responses to this survey than our previous, although we contacted the same firms. Table 2 summarises, at a high level, the different responses received. Despite many fewer responses, firms estimated higher one-off and ongoing costs. Indeed, some firms that responded to both surveys uprated costs on average by a factor of 9, suggesting that their assessment of costs has increased substantially. That said, there remains sizeable differences between cost estimates provided by firms of similar sizes.

Table 2: Comparison of firm survey results

		Previous survey		Current survey	
		One off	**Ongoing**	**One off**	**Ongoing**
Assets under administration		19	£335bn	9	£350bn
Policy holders		19	18.3m	9	15.9m
One-off costs	**Total**	19	£10.1m	6	£17.6m
	Average	19	£0.5m	6	£2.9m
Ongoing costs	**Total**	19	£3.3m	5	£2.7m
	Average	19	£0.2m	5	£0.5m

Source: FCA firm survey

49. While there were fewer responses to our second survey, they still cover over 70% of the total AUA of impacted firms and so we expect that they be sufficiently representative of market-wide costs. We therefore assume that responses are broadly representative and were able to inform our cost estimates.

Standard assumptions

50. We also make the following standard assumptions in our analysis of the impacts of our proposals:

- Costs and benefits are analysed over a 10-year appraisal period following implementation.
- The present value (PV) of costs and benefits are estimated by applying a 3.5% discount rate, in alignment with HM Treasury's Green Book.
- Firms comply with our proposed rules (where relevant).

Summary of Impacts

51. We have estimated total costs of implementation of £57.3-159m and expect benefits to consumers of £0.6-1.7bn, providing a NPV of £0.5-1.6bn. The range is driven by uncertainties in responses from firms and the scale of improvement by underperforming firms. Given the size of pension funds, a relatively small uplift in performance is needed to generate positive benefits.

52. Given the size of the market, relatively minor benefits to consumers need to accrue in order to generate a positive NPV. We estimate we would need to generate average benefits per policy of £2.89-8.03 over the ten year period. We consider this likely to be achieved.

Table 3: Summary table of benefits and costs

Group affected	**Item description**	**Benefits (£)**		**Costs (£)**	
		One off	Ongoing	One off	Ongoing
Firms	Familiarisation costs			£0.3m	
	Compliance costs			£22.3-61.7m	£4.1-11.3m
	Increase in fees		*Transfer*		
Consumers	Improvement in investment performance		£0.6-1.7bn		
	Improvement in quality of service		Unquantified		
	Increase in fees				*Transfer*
Total			£0.6-1.7bn	£22.6-62m	£35-97m

Table 4: Present Value and Net Present Value

	PV Benefits	PV Costs	NPV (10 yrs) (benefits-costs)
Total impact	£0.6-1.7bn	£57.2-159m	£0.6-1.7bn
-of which direct		£57.2-159m	£57.2-159m
-of which indirect	£0.6-1.7bn		£0.5-1.6bn
Key unquantified items to consider	Improved quality of service	Potential scheme transfer fees	

Table 5: Net direct costs to firms

	Total (Present Value) Net Direct Cost to Business (10 yrs)	EANDCB
Total net direct cost to business (costs to businesses - benefits to businesses)	**£57.2-159m**	**£6.7-18.5m**

Benefits

53. In this section, we set out the benefits we expect to arise from our proposals to stakeholders. Benefits are primarily expected to accrue to savers through improved performance, leading to larger pots in retirement.

Benefits to savers – improved performance

54. We expect our proposals to benefit consumers by improving outcomes within default pension schemes, leading to larger pots upon retirement. This will be driven by pressure on firms to improve performance from several sources:

- **Pressure from employers** – firms will be incentivised to improve performance on metrics where they are weak as otherwise employers will switch to a scheme which provides better value. Research conducted by DWP showed that most employers across all sizes believed that value for members was a priority when considering switching schemes and they were likely to show this through their actions or views about the benefits of pensions
- **Adverse impacts from ratings** – arrangements that are amber-rated cannot accept new members, and a red-rated scheme will be required to transfer its members if it does not improve. We expect that concerns over these negative impacts will drive improvements in schemes rather than mass switching.
- **Transfers from outdated schemes –** older and historic schemes can provide worse outcomes to inert consumers that have not transferred out. By offering a mechanism to transfer these consumers to newer schemes, VFM can enable these consumers to have better retirement outcomes.
- **Regulatory focus** – schemes have previously had an outsized focus on costs, partially due to regulatory initiatives which encouraged this perspective. The shift

towards value will enable firms to make decisions that ensure value is considered more broadly and firms can take action to deliver this value.

55. Overall, we expect that these factors will drive an improvement in performance within pension pots by "closing the gap" between the worst and average performers. This increase in performance may result from:

- **Changes in asset allocation** – pension schemes may be able to allocate more assets to higher-cost products that provide better net performance or otherwise adjust their risk profile to increase performance, including private assets.
- **Improved efficiency** – pension schemes that can improve their internal efficiencies through lower costs and better services will offer better returns to their customers.

56. As part of our 2024 survey to firms, we asked them to provide the net AUM-weighted performance of their in-scope schemes and AUM-weighted fees. Using this data, we estimated market-weighted annual net investment returns of 2.5% to 5.9%, with an average of 4.4%. We asked for this information in our updated survey but received too few responses to undertake a robust analysis, therefore we have maintained our previous analysis but uprated to an increased market size.

57. Where returns are below the market average, we calculate the gap between their returns and the average and multiply this by their workplace personal pension assets. For the total gap in the market, we sum across all underperforming firms and scale to the total market size. For a market size of £422bn, we estimate an initial investment performance gap of £1.8bn.

58. We then assume that the VFM framework improves performance in these schemes by 1-3%, such that the gap in performance reduces by 5-15% over the next 5 years. We think that the closure of this gap at this rate is a reasonable and relatively small impact for the VFM framework to achieve based on the drivers above. However, we acknowledge that there is little evidence to support this assumption, which should be viewed as illustrative. A breakeven analysis is presented to provide a sense of the required benefits that are necessary to be achieved for our proposals to be net beneficial.

59. Note that this is not an annual 1-3 percentage point increase in performance, but a reduction in this gap by 1-3%. For example, a scheme returning 3% compared to a market average 5%, would see an increase in performance to 3.02%-3.06%. Applying this decrease to the £1.8bn gap implies a total benefit from of £0.6-1.7bn, Table 7 and Table 8 sets out the annual change for a 1% and 3% increase, respectively. Our analysis is set out in greater detail in CP24/16.

Table 5: Assumptions

Assumption	Value
Size of the market	£422bn
Initial gap in performance	£1,798m
Annual improvement	1-3%
Time value of money	3.5%

Table 7: **Improvements: Result of the introduction of the VFM Framework in year (£mn) – 1% increase**

Year	1	2	3	4	5	6	7	8	9	10	Total
1	18.0										18.0
2	17.4	17.2									34.6
3	16.8	16.6	16.4								49.8
4	16.2	16.1	15.9	15.7							63.9
5	15.7	15.5	15.4	15.2	15.0						76.8
6	15.1	15.0	14.8	14.7	15.0	0.0					74.7
7	14.6	14.5	14.3	14.2	14.5	0.0	0.0				72.2
8	14.1	14.0	13.8	13.7	14.0	0.0	0.0	0.0			69.7
9	13.7	13.5	13.4	13.2	13.6	0.0	0.0	0.0	0.0		67.4
10	13.2	13.1	12.9	12.8	13.1	0.0	0.0	0.0	0.0	0.0	65.1
Total	**155**	**135**	**117**	**100**	**85**	**0**	**0**	**0**	**0**	**0**	**592**

1% improvement in performance
Benefits are discounted and presented in present values

Table 8: **Improvements: Result of the introduction of the VFM Framework in year (£mn) – 3% increase**

Year	1	2	3	4	5	6	7	8	9	10	Total
1	53.9										53.9
2	52.1	50.5									102.7
3	50.3	48.8	47.4								146.6
4	48.6	47.2	45.8	44.4							186.0
5	47.0	45.6	44.2	42.9	41.6						221.3
6	45.4	44.0	42.7	41.4	41.6	0.0					215.2
7	43.9	42.6	41.3	40.0	40.2	0.0	0.0				208.0
8	42.4	41.1	39.9	38.7	38.8	0.0	0.0	0.0			200.9
9	41.0	39.7	38.5	37.4	37.5	0.0	0.0	0.0	0.0		194.1
10	39.6	38.4	37.2	36.1	36.3	0.0	0.0	0.0	0.0	0.0	187.6
Total	**464**	**398**	**337**	**281**	**236**	**0**	**0**	**0**	**0**	**0**	**1.716**

3% improvement in performance
Benefits are discounted and presented in present values

Benefits to firms – increased fee revenue

60. Pension schemes may stand to generate increased revenue from their management charges where they improve performance following the implementation of the VFM framework. These fees will be a direct transfer from savers to firms and the counterpart of the increased fees noted in *costs to consumers.*

Costs

61. This section sets out the costs we expect to arise from our proposals. We expect most costs to be incurred by firms in implementing and maintaining the VFM framework.

Costs to firms

Familiarisation costs

62. We expect all 21 firms will need to read our CP and rules to understand the implications for them. We use our standardised cost model (see Appendix 1 of 'How we analyse the costs and benefits of our policies – 2024' for more information) to estimate how much it will cost firms for their compliance and legal staff to familiarise themselves with our publications.

63. Compliance and legal staff at these firms will have to read the papers we publish. We have estimated this will be 100 pages of Consultation Paper and annexes, and 80 pages of legal text (we will update this in the PS if the final length is significantly different). We expect the following costs:

Table 9: Familiarisation costs

Firm size	Cost per firm	Total cost
Small	£1,400	£2,900
Medium	£7,200	£64,800
Large	£23,100	£231,400
Total	£14,238	£299,000

Source: FCA analysis

Compliance costs

64. We expect firms to incur one-off costs setting up their systems to produce the metrics. This will include initial IT and systems costs to develop the metrics and publish them in a prescribed template.

65. We also expect ongoing costs through additional meeting times, maintaining systems, and supporting IGCs. There may need to be upskilling and specialist support for IGCs to undertake additional activities in line with our proposals.

66. We based these costs on the information that firms provided in response to the survey.

67. In our previous firm CBA, we had concerns over the costs provided by firms, and they found it difficult to estimate implementation costs without proposals. Some firms have provided updated information to our latest survey; however, we received many fewer responses, predominantly from larger firms. To capture the large discrepancies in costs we provide a wide range based on both our current and previous survey information.
    - The lower bound is approximated by estimating a cost per policyholder from our latest survey and applying this to the market.

- The upper bound is estimated by applying the average costs reported by firms in our current survey to all firms.

68. For the lower bound, we sum the total one-off and ongoing costs from survey respondents and divide these by the total number of policyholders in their schemes to find a cost per policyholder. We then apply this to the total number of policyholders represented by our firms, as set out in Table 10 below.

Table 10: Lower bound costs

Firm size	One-off	Ongoing
Costs submitted by firms (a)	£17.6m	£3.2m
Policyholders represented (b)	15.8m	15.8m
Cost per policyholder (a ÷ b) = (c)	£1.12	£0.21
Total policyholders (d)	19.8m	19.8m
Total cost (c × d)	£22.3m	£4.1m

Source: FCA analysis

69. For the upper bound, we simply take the average of costs firms reported in our updated survey and apply this to the entire population of firms. On average, firms reported one-off costs of £2.9m and ongoing costs of £0.5m. This leads to total one-off costs for all 21 firms of £61.7m and ongoing costs of £11.3m.

70. Overall, over 10 years we expect total costs to firms of £57.2-159m (NPV). We do not provide a breakdown of costs as respondents to our surveys found it easier to provide total costs, given they deliver projects as part of one programme of work.

Underperforming schemes

71. Where firms are underperforming and receive a red or amber rating, they may incur costs in moving members out of their current schemes or face reductions in revenue where they cannot onboard new members, although this would likely be a transfer to an alternative scheme. In our survey we asked firms to estimate costs of switching consumers out of schemes of different sizes, we received only 2 responses to this question, so we are unable to provide expected cost estimates.

72. We do not assign any probability to the likely rating of different schemes, so cannot estimate the extent to which we expect these costs to be incurred. Moreover, as set out earlier, we largely expect underperforming schemes to improve, rather than undertake mass-switching. Therefore, we do not include these costs in our NPV.

Costs to consumers

Increased fees

73. Pension schemes will likely pass through any additional fund management costs directly to consumers. However, we expect that this will be offset by increased performance. In our *benefits to consumers* section, we estimated the closing of the gap in net terms, which implicitly offsets the cost of additional fees.

Costs to the FCA

74. We do not expect our proposed measures to lead to any significant direct costs to the FCA. Supervision and enforcement of the proposed rules will be undertaken using existing resources, this includes reviewing improvement and action plans that will be sent to us by those assessed as not value for money.

Wider economic impacts, including on secondary objective

75. By increasing competition amongst default pension providers, we expect the VFM proposals can influence economic growth in the UK primarily through two channels:
    - **Improving firms' access to finance** – the VFM framework will enable pension schemes to invest in a wider range of assets, including supporting their commitments under the Mansion House Accord to invest 5% of their default assets into UK private markets. By increasing capital allocations to private assets, including start-ups and scaling business, VFM can enable innovation and competition within the wider economy, supporting productivity and driving long-term growth.
    - **Empowering consumers –** we expect that the VFM framework will lead to better overall investment performance for UK savers. This will lead to increased pension pot size in retirement for many individuals who were previously in underperforming schemes. Subsequently, these savers will be able to consume more in retirement, contributing to an increase in GDP.

Risks and uncertainties

76. Our proposals are intended to strengthen competition on long-term value by requiring more comparable disclosures, more objective assessments, and clearer consequences where arrangements are assessed as not delivering value for money. However, there is a risk of unintended responses by firms. Firms may place increased weight on how their arrangements compare with peers over the assessment horizon, rather than on the investment strategy that is most appropriate for members over the longer term.

Herding

77. Providers are required to compare themselves against commercial market comparators and are incentivised to avoid performance falling materially below the average, some providers may respond by adopting strategies closer to those of their peers. This risk may be more acute where there are significant commercial or regulatory consequences associated with an adverse rating, and where market consolidation reduces the range of comparator strategies. The result may be pension schemes coalescing around the average performing fund rather than driving overall increases in performance. If this were to happen, there may be a corresponding reduction in performance from high-performing funds.

78. Our current proposals seek to mitigate this risk - there is no formal regulator-set benchmark and assessments can take account of a limited set of additional factors. Additionally, high-performing schemes are unlikely to alter their asset allocation to align with a worse performing scheme. Nevertheless, we consider herding to remain a relevant risk.

Excessive risk-taking

79. Where firms perceive a material downside from underperforming peers or from receiving a weaker assessment, they may have an incentive to increase risk-taking in order to improve relative performance over the relevant assessment period.

80. Where comparative performance becomes more salient, for example by comparison to a benchmark, underperformers may respond by taking more risk than is optimal for long-term member outcomes. Should this occur, members may be exposed to greater losses if these investments are unsuccessful.

Large-scale asset movements

81. If adverse assessments ultimately lead to multiple firms moving material volumes of assets over a short period, there may be wider market effects. There is a potential risk to customers of fluctuation in market performance from large values of funds being bought and sold by a number of providers in a short period, following a red rating.

82. We do not think it is reasonably practicable to quantify these risks.

Rebalancing risk

83. In identifying how interventions in the pensions market can support both FCA strategic and operational objectives, we consider our approach from a perspective of "rebalancing risk". We are not a zero-fail regulator, and we accept that risk plays a vital role in innovation. We assessed that this market had some consistently underperforming funds, and consumers were not empowered to pressure these funds to improve returns. Alongside other reforms to make the pensions market more transparent and accessible, this should cause firms to compete more on returns for savers than cost to businesses. This should lead to firms pursuing more effective and potentially costlier strategies to improve returns. This approach is not about accepting harm, but rather about ensuring we make balanced, risk-informed decisions that reflect the real-world complexity of dynamic markets, and allow us to be a smarter, more adaptive regulator.[2]

Monitoring and evaluation

84. **Monitoring**: We will monitor firms' compliance with the new rules through our usual regulatory tools, including assessing the burden compliance is placing on firms. We can also monitor the VFM metrics to assess whether firm performance is improving on a continuous basis. This will enable us to test our assumptions and see whether the gap in performance is declining as we expect.

85. **Evaluation**: If we implement these proposals, we believe these will help ensure that schemes deliver long-term value for savers, which we could measure through the proportion of arrangements assessed as not VFM over time, the average score of each metric over time, and any consequent market consolidation over time. Given firms will be publishing metrics for their schemes, there are opportunities to undertake an evaluation once the proposals have been implemented. We will be able to evaluate performance of schemes, changes in asset allocation, and fees to ensure our proposals are delivering VFM for consumers. Although it may be difficult to isolate the impact of VFM, the rich data should enable strong conclusions to be drawn about the efficacy of the framework.

[2] Our assessment has not changed from CP26/1 and so this is simply restated.

Consultation with the FCA Cost Benefit Analysis Panel

86. We have consulted the CBA Panel in the preparation of this CBA in line with the requirements of s138IA(2)(a) FSMA. A summary of the Panel's main recommendations and the actions we took in response to the Panel's advice is provided in Table 11 below. In addition, we made changes based on wider feedback from the CBA Panel on specific sections of the CBA. The CBA Panel publishes a summary of their feedback on their website, which can be accessed here.

87. We received an additional survey response from a firm during the CBA Panel review period and have subsequently updated figures with this information.

Table 11: CBA Panel feedback

CBA Panel main recommendations	Our response
Market characterisation could be better argued and evidenced. The CBA does not sufficiently reflect the complexity of the pensions market, including the role of intermediaries such as advisers, employer decision-making, and the extent of competition between providers. The scale and distribution of market failures are not clearly demonstrated, and in some cases appear to be asserted rather than evidenced. There is also limited recognition of heterogeneity across the market, including the extent to which parts of the market are already functioning effectively.	In response to previous panel feedback, we will shortly be publishing a market note, which provides more detail on the economic context of the UK pensions market, to reduce the length of our CBAs. This note will address and discuss many of the structural participants and competitive dynamics. We have added additional evidence to the body of the CBA related to market failures and size of the harm.
Costs and benefits assessment is not always well explained or justified. In particular, cost estimates are driven by a small number of firm survey responses, with limited information on what firms are being asked to do or how the underlying activities translate into costs, and no clear description of the required metrics. Whilst we appreciate the additional survey information from industry, there is little triangulation or validation of these estimates. On the benefits side, the assumed 1–3% reduction in the performance gap is a key driver of results but is not well justified and cannot be independently	We relied on past consultations in our survey to firms. The activities we expect them to undertake have remained largely consistent through the phases of this consultation, so we consider this a reasonable proxy for the costs they will incur. Changes to our proposals are primarily intended to reduce burden over the course of the 3 consultations. We accept the 1-3% assumption is a key driver of benefits and include a breakeven to acknowledge the sensitivity. We have added a qualitative discussion of risks arising from our proposals but

validated. Given the scale of estimated benefits relative to costs, this creates a high degree of sensitivity in the overall conclusions.	do not think it is reasonably practicable to estimate these risks quantitatively.
Monitoring and evaluation discussion is underdeveloped. The CBA provides only a high-level discussion of monitoring and evaluation, with no clear articulation of metrics, timelines, or review points. It is unclear why evaluation would be undertaken separately rather than embedded within the policy framework, particularly given the uncertainty around key assumptions and the importance of testing whether anticipated benefits materialise.	We have added some more information on the assessments we could undertake, and noted the testing of assumptions. While we have not committed to a specific timeframe for evaluation, the increase in data availability provided by the VFM framework will enable us to undertake continuous monitoring and evaluation.