B&CE response: CP 19/15: Independent Governance Committees: extension of remit

About us

B&CE is the provider of the People's Pension, a not-for-profit master trust which delivers a workplace pension to more than 4 million mostly low and medium income savers. B&CE is a not-for-profit provider of straightforward financial products, founded by construction industry employers and trade unions in 1942. We have recently completed the transfer of nearly half a million customers from our legacy contract based DC arrangement to The People's Pension master trust because of the higher governance standards and lower charges of the latter.

Introduction

We are grateful to respond to this consultation. While we do not agree with a proportion of the policy direction outlined in the consultation paper, we are grateful for the opportunity to feed back. We hope that the FCA finds our perspective useful.

We see the IGC model as fundamentally weaker than governance of pensions by a fiduciary

In our response to DP18/5 we argued that the IGC model is weaker than the trustee model. While the legal duties on trustees and IGCs are superficially similar, the IGC's capacity for conflicts of interest and limited advisory role render them less suitable as a model for the running of workplace pension arrangements. As such, in our response to DP18/5 we argued that:

The OFT's 2013 report into UK DC identified the problem of conflicted interests and poor governance leading to poor outcomes. The OFT recommended that policy should be used to promote "robust independent governance" resulting eventually in Independent Governance Committees. The IGC model is a flawed first attempt at delivering "robust independent governance". The flaws are they are not necessarily required to be entirely independent and they are not governing either.

In a master trust or single employer trust, the trustees run the scheme. They are responsible in law for the running of the scheme and it is the trustees that will have to apply for authorisation as a master trust pension scheme. In the authors' experience, trustees of larger schemes are treated in a manner similar to board members in a publicly listed company. Those familiar with PLC board members will know that shareholder value is a constant concern. Replacing "shareholder" with "member" will provide a feel for how trustees operate. The trustees can sack the underlying provider if they deem that it is no longer meeting the members' best interest. The requirements on trustees to avoid conflicts of interest are strict.

IGCs do not have the same legal powers as trustees. They have an advisory rather than an executive role. While in theory, they could complain to the FCA if their views are ignored, this power is far weaker than that of trustees. The provider of contract based pensions can decline to reappoint them and it is permitted to appoint a minority of members of the IGC who are not independent. The latter can feasibly monitor the behaviour of the independent members on behalf of the firm. Those appointees meeting the definition of independence include employees of other companies providing services to the contract-based provider, as long as Chinese walls are appropriately managed. This comprises another example of hoping that behavioural rules will overcome structural incentives.

Taken together, we do not see the governance arrangements of contract based schemes as a meaningful restraint on the profit motive. In other words, there is a direct conflict between the interests of savers and the interest of the providers that is not adequately mitigated by the governance provisions in COBS.

Alignment of COBS with occupational scheme provisions on ESG is sensible but potentially undermined by IGC's weakness.

We welcome the proposed alignment of COBS with the revised ESG provisions that amend the 2005 investment regulations. We saw the separation of risk evaluation in the revised investment regulations into financial and non financial risks as the logical way to include financially material ESG risks within the investment risk evaluation framework for occupational pensions. Alignment between the investment regulations and COBS will ensure a common basis for both trust and contract based pension schemes to address climate change and other financially material ESG risks.

We are concerned, though, that the advisory nature of IGCs hands them the responsibility to address contract based providers' approach to climate change but not the power to actually drive the agenda within those providers. This is in marked contrast to the way the 2005 investment regulations operate for trust based schemes where the SIP is very much the trustees' document and the policy on financially material risks the trustees' policy on those risks. It is not clear to us that IGCs will be able to have sufficient impact on this critical issue in the absence of meaningful powers.

We are concerned that there will be no independent governance of retirement products

We see the IGC model as weaker than other available models for the governance of pensions and in need of improvement, as per our earlier comments. But we do see the extension of governance committees to retirement products as desirable. This is for several reasons.

First, an increasing proportion of customers making at retirement decisions will have benefitted from products governed by a trustee or oversee by an IGC during accumulation. While they may not realise this, as the governance of pensions is a niche concern, they will be used to an environment in which a surrogate customer is acting on their behalf.

Second, we see the buy side at retirement as fundamentally weak. This is partly corrected by the availability of financial advice but we do not recognise the characterisation of the buy side implicit in para 4.22 of the consultation document:

We agree that consumers who are advised (and continue to be advised) or who have carefully selected a decumulation product (and continue to be engaged with their choice) are less likely to need protection from poor value products.

MAS financial capability survey suggests that only 48% of the adult population feel comfortable making a financial product selection. That research question applies across financial services and therefore likely overstates self-reported ability with respect to complex products like FAD. Furthermore, the FCA stated in PS19/1 that:

Our previous Thematic Review on Annuities found that 39% – 48% of consumers who bought a standard annuity from their existing provider may have been eligible to buy an enhanced annuity.

We are therefore not sure what justifies the use of the term "carefully selected" in the consultation document or the supposition that non-advised retirees will continue to be engaged with their decumulation choices. These seem to us likely to be true for a minority of retirees and not a suitable basis on which to make decisions about how decumulation products should be governed.

For those purchasing decumulation products without ongoing advice, the available evidence suggests a buy side that is systemically weak. In the accumulation phase, both in occupational and contract based pensions,

improved governance was seen by government as an integral part of the solution. We think similar arguments apply in decumulation.

1. Do you agree that IGCs should report on the adequacy and quality of their firm's policies on ESG issues, member concerns and stewardship?

The draft handbook text approximates the revised text in the 2005 investment regulations. This means that trustees and IGCs should use a similar framework to evaluate financial risks. We further note that the draft handbook text also contains an approximation of the "two step" test for the consideration of non-financial risks by trustees in the context of investment set out by the Law Commission in 2015. We agree both with the FCA's intent and also with the way in which the material has been transposed from the Occupational Scheme Investment Regulations and also the way that the "two step" test has been codified from the Law Commission's view of trust law.

Our concerns follow on from our response to the recent FCA consultation on a proposed new duty for financial services firms. In that response we suggested that pensions are better governed by a fiduciary than by and IGC. This is because both the legal requirements to which a fiduciary is subject and the powers available to them are greater. We believe this achieves a greater degree of alignment between the interests of beneficiaries and those running the pension scheme.

The 2005 investment regulations are partly concerned with the preparation of the SIP. The SIP is the trustees' document and, while they must take advice when preparing it, they remain accountable for it. It follows that any policy on financially material risks is the trustees' policy. The same will not be true for IGCs. Any policy on evaluation of non-financial risks will be that of the IGC's parent provider and the requirement for the IGC to report on the policy is fundamentally different to the requirements on occupational pensions.

We do not see this sort of disparity as desirable. The ability of the IGC to meaningfully influence the content of any policy is limited. The intention seems merely to be for the IGC to report on the content of the policy. That would most likely take place after the policy has been drafted. There is a risk that the IGC will be seen as a compliance gateway rather than as a body "governing" the running of a pension provider in any real sense.

We recognise that this critique runs wider than the consultation and speaks more to general issues with the IGC model. But, the policy intent seems to be to influence pension providers to take more account of ESG issues in their investment approaches. The responsibility for this seems to lie with the IGC in the FCA's proposed formulation but the IGC does not really have the powers to influence the provider. We do not see responsibility without power as a route to success.

2. Do you agree that IGCs should report on how the firm has implemented its policies on ESG issues, member concerns and stewardship?

Our response is similar to our response to question one. We agree with the policy intent but do not think that the IGC has sufficient powers to influence their parent provider.

3. Do you agree that IGCs should report on the firm's policies on these issues for both pathway solutions and workplace personal pensions?

Yes.

4. Do you agree that firms should make the IGC's annual report publicly and prominently available, with 2 prior year reports for comparison?

Yes.

5. **Do you agree that the proposed guidance should apply more widely, to all firms that provide pension products and all life insurers that provide investment-based life insurance products?**

No response.

6. **Do you agree that we should focus our requirement for an IGC on firms offering pathway solutions to consumers?**

Yes.

7. **Do you agree with our proposed approach for providers with smaller numbers of non-advised consumers entering drawdown?**

Yes.

8. **Do you agree that IGCs must be in place in time to assess the initial designs of pathway solutions?**

Yes. Once products are "baked" it is typically much more difficult for those charged with assessing them to alter them.

9. **Do you agree that we should be more prescriptive in our rules and guidance for firms and/or IGCs on how value for money should be assessed?**

No response

1. **We welcome your view on what legacy pension products should be compared with, when assessing value for money.**

No response.

2. **Do you agree with the conclusion and analysis set out in our cost benefit analysis?**

No response.