B&CE response to the FCA DP18/5: a duty of care and potential alternative approaches

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.

Executive summary

We welcome the opportunity to comment on the FCA's discussion paper on a new duty for financial service providers. In this paper we argue that fiduciary duty should be the governance standard for both trust and contract based workplace pension providers. Fiduciary duty is superior to the provisions in COBS in placing savers' best interests at the heart of workplace pension provision. It is internationally recognised as the best basis on which to govern workplace pension provision. It is also the basis on which UK workplace pension provision was founded and is therefore familiar and well understood across the workplace pensions sector.

Our starting point is the saver. UK savers would be surprised to learn that there are two different governance standards operating in the workplace pensions sector offering two different levels of consumer protection, with one being substantially weaker.

Contract based products work less well in the consumer's interest because the interests of shareholders dominate in a market with a very weak buy-side. These tensions are not resolved by the FCA's current regulatory rules.

In this context, fiduciary duty is a more appropriate policy tool than a duty of care. Duties of care speak mainly to issues of competence while fiduciary duties speak mainly to the issues of motive and incentive alignment. The policy problem in workplace pension governance is the way in which the tension between the interests of providers and the interests of savers seem to be resolved in the interests of the former. Fiduciary duty is the most appropriate means or resolving this tension in favour of the saver.

These issues can be clearly seen in practice. Charges in the contract based sector are, on average, higher than in the trust based sector. The mean charge in a master trust scheme is 45 basis points. Charges in contract based workplace products vary but are typically higher than 45 basis points for all but the largest employers. The UK is an economy where most people do not work for large employers.

Various other market practices, now banned, such as active member discounts and some forms of exit charge were interpreted by providers as compatible with COBS principle six. In these latter cases, it required action by government and not regulatory action to resolve issues of consumer detriment. Furthermore, there is no equivalence between trustee board and IGCs; the latter are neither independent nor governing. They are merely advisory bodies, lacking in executive power and allowing the appointment of members with conflicts of interest.

Similar issues can also be seen in decumulation. The FCA's Retirement Outcomes Review showed how charges for drawdown varied from 40 to 160 basis points for substantially the same product, an unjustifiable range.

Evidence from other countries, including the Netherlands, shows that there is a strong association between integrity and trust. Where providers are perceived to act with integrity they are more likely to be trusted than other providers.[1] Fiduciary duty, insofar as it focuses on the beneficiary and prohibits conflicts of interest, is the obvious route to demonstrating that integrity.

The optimal model for a DC pension arrangement is trust based governance accompanied by scale. There are over 30,000 trust based DC schemes and c. 5,000 trust based DC schemes with more than 12 members. This is too large a number of schemes for schemes and trustees to be appropriately resourced to serve members. Larger schemes can more easily access better quality governance and economies of scale.

Introduction

We are grateful for the opportunity to respond to this discussion paper on the potential creation of a new duty to be placed on FCA regulated providers of financial services. This issue raises many questions for the provision of workplace pensions. First, whether or not a new duty should be applied to contract based workplace pensions. Second, whether a new duty should be imposed on firms that provide services to pension schemes.

Both issues are important to the future of workplace pension provision in the UK. In this response we limit ourselves to discussing the governance of workplace pension schemes. This is because the issue of fiduciary duty in the investment chain was considered after the Kay review.

A neutral international observer addressing the first set of issues, would, if they were ignorant of the peculiarities of the UK pension system, probably be surprised that a fiduciary duty was not already in place. A fiduciary duty is generally recognised as the optimal mechanism for ensuring incentive alignment between savers and providers. Countries where workplace pension providers must operate under a fiduciary duty or similar include Australia, the Netherlands, New Zealand, Switzerland, and the United States.

The OECD has noted that:

"the basic goal of pension fund governance is to minimize the potential agency problems, or conflicts of interest, that can arise between the fund members and those responsible for the fund's management…" [2]

They further suggested:

"contract-based DC pension plans also present a major governance challenge in many countries that needs to be addressed urgently. These concerns emerge largely from the absence in such arrangements of a trustee or an equivalent governing body that represents exclusively the interest of plan members…The fiduciary responsibilities of sponsoring employers (in occupational plans) and providers (in personal plans) could also be clarified in order to ensure that the plans are managed with appropriate care and with the interest of the members in mind." [3]

In this response, we set out the reasons why a fiduciary duty is a key requirement for eliminating conflicts of interest which can prejudice interests of savers and the steps that we believe the FCA could take to introduce such a duty.

[1] https://pure.knaw.nl/ws/files/5724403/2017_Van_Dalen_en_Henkens_Netspar_disc.paper_publ_version_v078.pdf

[2] Stewart, F. and J. Yermo (2008), "Pension Fund Governance: Challenges and Potential Solutions", *OECD Working Papers on Insurance and Private Pensions*, No. 18, OECD Publishing, Paris, https://doi.org/10.1787/241402256531; p.6.

[3] Ibid, p.32.

Starting with the consumer

Our starting point for addressing this issue are the interests of the end consumer. At the moment, consumers are automatically enrolled into workplace pensions by their employer. In order for automatic enrolment to operate effectively, consumers are offered a workplace pension on a "take it or leave it" basis. Employers select the scheme and it is unlawful for employers to make participation in pension saving contingent on an active choice by the employee.

It would come as a surprise to many savers that there are different kinds of workplace pension and that the level of consumer protection in each varies. We think it would be hard to justify different levels of consumer protection in workplace pensions, even if consumers had an active choice in the matter. As consumers have little or no meaningful choice over the level of protection they receive, workplace pensions should be aligned at the higher of the available standards of governance[4].

Why we believe fiduciary duty is a higher governance standard

In this section we look briefly at two issues. First, the differences between the governance regime for trust and contract based pensions. Second, we look at the differences between a duty of care and fiduciary duty.

While the FCA's discussion paper has enabled a useful discussion of product governance in financial services, the way that the paper characterises fiduciary is somewhat idiosyncratic. The discussion paper states:

"A duty of care and a fiduciary duty, therefore, have somewhat different purposes. A duty of care is a positive obligation that aims to ensure that people are not reckless or incompetent whereas a fiduciary duty is largely a prohibition on acting in a way that is somehow disloyal or improper."

This is only a partial description of fiduciary duties. It omits some of the most important and positive obligations of a fiduciary in the governance of pensions. The positive obligations under which pension scheme trustees operate include the critical and fundamental obligation to act in the interests of the scheme's beneficiaries. Trustees are also under duties to act with prudence and with reasonable care and skill[5]. A duty of care is consequently one sub-element of the duties which the fiduciary duty requires the trustee to meet. Note that it should be logically impossible for the duty of care to be described as positive and a fiduciary duty as essentially a set of prohibitions, when the fiduciary duty includes a duty of care.

This leads us to two observations about the difference between a duty of care and fiduciary duties. First, while a duty of care speaks largely to issues of competence: the care and skill with which particular actions are performed, fiduciary duty goes further to also include issues of motivation and intent.

Second, an individual breach of a duty of care is usually assessed by courts looking at what is "reasonable". This is typically assessed by looking at standard industry practice. This may not be much help to consumers if standard industry practice is flawed. In contrast, a fiduciary duty requires that a trustee act in the best interests of the members. A trustee could not argue that because other industry participants acted in other than the best interests of their members that they could also reasonably expect to do so. For a practical illustration of this difference, note that contract providers felt legally secure in imposing higher charges on deferred members whereas trustees did not. This was also an issue on which the FCA did not feel it could use its powers and the legislator was required to intervene.

As such, a duty of care and an over-arching fiduciary duty are tools for achieving different objectives. A duty of care would seem to be a reasonable lever to pull if issues of consumer detriment in financial services were seen to result from incompetence on the part of provider. We do not believe that to be the case in the provision of contract based pensions.

---

[4] A fiduciary duty is normally considered the highest form of duty an individual can legally have towards another: https://www.stimmel-law.com/en/articles/fiduciary-duty-what-it-and-what-does-it-impose-upon-you

[5] While not exactly the same, this is substantially similar to the duty of care imposed by the consumer rights act

Rather, we see the issue of motive as critically important in the governance of pension schemes and providers. Trustees have a binding obligation to consider the best interests of their scheme membership and then act in those interests. That means the primary motive force in a trustee governed pension scheme should be the best interests of the beneficiaries. This is extremely important in a market where savers are automatically enrolled into schemes, where there are substantial information asymmetries between the saver and the scheme and where customers are typically inert and make few active choices.

In that context, savers constitute an exploitable population. They should be protected by regulation, which is why we have been strong supporters of the new authorisation regime for master trust pension schemes. It is also why we have supported the charge cap. Members should have confidence that those running the scheme are legally obliged to act in their best interests.

The obligations on trustees and contract based providers are not in practice equivalent

While the legal obligations applying to trust and contract based schemes may appear superficially similar, there are a number of significant differences.

Formally, the rules look similar. Trustees have a duty to act in the best interests of beneficiaries. FCA principles require providers to have "due regard for the interests of customers and treat them fairly." There is a further obligation in COBS 2.1.1R that a firm should act "honestly, fairly and professionally in accordance with the best interests of its client."

First, in the contract-based system, there is an implicit assumption that providers should be able to profit from their activities. However, as the OFT established in 2013, we do not have a normal market in workplace pensions which generates demand-side pressures on supplier behaviours and as a consequence, there needs to be effective constraints on the ability of providers to extract rent from pension products. The balance between a provider's obligations to its shareholders and the obligations in principle six is not, though, set out elsewhere in COBS, so it is unclear what constitutes a fair or an unfair level of charging. In addition, depending as to the view taken as to the characteristics of the client, it is arguable that best interests can be met by providing information rather than acting on behalf of someone to secure their best interest for them. (Note that when comparing COBS 2.1.1.R and a fiduciary duty, 2.1.1.R refers to "client" as opposed to "beneficiary" and this is likely to impose different assumptions about appropriate levels of protection).

Second, clearly the FCA does not itself regard its principles as sufficient to influence behaviour. If they were sufficient to affect the behaviour of firms then there would be less need for continuous evolution of behavioural rules governing the conduct of contract based providers. Repeated interventions, where the regulator is constantly trying to catch up with individual items of conduct of which it disapproves is essentially a process up of tidying up problems after they have occurred. Obviously, fiduciary duties do not preclude the need for regulation, but the nature of that regulation may be less prescriptive and intended more to ensure that fiduciaries are capable of performing their roles and are empowered to do so[6].

The weakness of behavioural rules compared to structural rules in dealing with breaches of competition law is an issue well-known to competition lawyers and the situation in pensions is analogous. Behavioural rules do not change underlying incentives. The OECD has put it as follows: "behavioural policies, unlike structural policies, do not eliminate the incentive of the regulated firm to restrict competition…despite the best efforts of regulators, regulatory controls of a behavioural nature, which are intended to control the ability of an integrated firm to restrict competition, may result in

[6] Many commentators, from the Pension Regulator to the OFT to the OECD to the CMA have identified that where there are problems with trustee governance, it is typically a consequence of a lack of scale. We would be happy to submit further comments on how the UK could promote scale provision of pensions.

less competition than would be the case if the regulated firm did not have the incentive to restrict competition [in the first place]."[7]

Third, we see the different basis on which trustees and providers are remunerated as driving behaviours. One of the key elements of fiduciary duty is not to make a profit from the role. Trustees can charge a flat fee for their own services but no more. Where they buy in services from other service providers, they must satisfy themselves that the process delivers in the best interests of their members. The duty on contract based providers is to deliver for their shareholders by maximising profit, subject to any regulatory constraints. This may lead them to inappropriately favour in-house services or to allow members to easily default into them even when they are inappropriate.

Fourth, as a matter of enforcement, trustees are at much greater risk of challenge than contract-based providers. As we noted under point 1 above, the balance between a provider's fiduciary duty to shareholders and the obligations in principle six is not set out elsewhere in COBS. While an individual can sue a contract based provider for breach of COBS 2.1.1.R under FSMA, these rules are insufficiently clear so it is not obvious how a court would interpret them, particularly as COBS 2.1.1.R. does not say how the company must meet the client's best interests. The Law Commission noted the possibility of suing under FSMA but did not consider it a sufficient mechanism to obviate the need to improve governance.

Independent Governance Committees: not equivalent to a trustee board

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.[8] 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 contract provider 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.

[7] OECD (2001) Recommendation of the OECD Council concerning Structural Separation in Regulated Industries, p. 2. For an academic discussion, see https://www.nera.com/publications/archive/2016/behavioural-versus-structural-remedies-in-eu-competition-law.html

[8] http://webarchive.nationalarchives.gov.uk/20140402194810/http://www.oft.gov.uk/shared_oft/market-studies/oft1505, p.167.

Impact on trust in pensions of not having trust-based governance

As the FCA have noted in their study of retirement outcomes, the pension industry is widely mistrusted. This is increasingly likely to cause serious problems to a UK policy of encouraging private pension provision. If auto-enrolment contribution rates are to be increased to levels capable of generating pensions with sufficient wage replacement rates in retirement, mistrust will likely encourage higher opt-out rates as contributions from present day income become increasingly significant.

The Institute of Public Policy Research reported in "Defining Ambitions" in 2013 as to what most consumers sought from a pension system. After assessing commentary in focus groups, they found that:

"Across the whole pension lifecycle (the investment period through to retirement), individuals want their interests to be protected without relying on their willingness or ability to shop around, weigh-up different options and make choices. They want expert independent guidance and oversight, closer to a doctor–patient relationship than a customer–supplier one. Potential members want to invest their pension savings into a trusted institution that is run by experts who can take decisions on their behalf and represent their interests. Ideally, pension providers should operate as non-profit organisations, and be strictly regulated and independent from the government."[9]

Similarly, Dutch researchers in 2017 published an empirical analysis of the underlying forces of trust in private pension providers in the Netherlands[10]. Based on a large-scale survey among pension participants, it found that the perceived integrity, competence, stability, and benevolence of pension providers matter in assessing the trustworthiness of pension providers. Pension funds are more trusted than banks or insurance companies, a difference that is primarily related to weights attached to perceived levels of integrity and stability.

Australia has the largest DC-based system in the world. Reviewing 25 years of data the Australian Productivity Commission[11] has just concluded: "Not-for-profit funds as a group have systematically outperformed for-profit funds"[12]. The not-for-profit pension funds are much lower cost providers than their more expensive for-profit rivals[13]. The Australian Productivity Commission found that "Higher fees are clearly associated with lower net returns over the long term"[14].

Permitting the continuance of a workplace pension model which does not put customers first is a mechanism for reducing confidence in a mass pension saving system.

[9] https://www.ippr.org/files/images/media/files/publication/2013/12/Defining-ambitions_%20Dec2013_11684.pdf, p.33
[10]https://pure.knaw.nl/ws/files/5724403/2017_Van_Dalen_en_Henkens_Netspar_disc.paper_publ_version_v078.pdf
[11] The Australian Productivity Commission is the Australian Government's principal review and advisory body on microeconomic policy, regulation and a range of other social and environmental issues. Its recommendations are typically turned into legislation. There is no equivalent senior independent UK body tasked with this set of duties.
[12] http://www.pc.gov.au/__data/assets/pdf_file/0014/228200/superannuation-assessment-draft-overview.pdf,p.44
[13] p.16.
[14] Ibid, p.47

Fiduciary duty is a necessary but not always a sufficient condition for good member outcomes

The optimal model for a DC pension arrangement is trust based governance accompanied by scale. There are over 30,000 trust based DC schemes and c. 5,000 trust based DC schemes with more than 12 members. This is too large a number of schemes for the available pool of skilled trustees. Larger schemes can more easily access better quality governance and economies of scale.

We believe that the solution here is consolidation. There are things the UK can learn from other countries where DC is the dominant form of retirement savings provision.

The Australian legislator has already amended the fiduciary duty of trustees to require them to consider whether they have the scale to deliver value for money for the member in default schemes. If they cannot deliver value for money, they are obliged to exit. Australian pension trustees are required to consider this on an annual basis. The Australian pension regulator is empowered to enforce the duty.

Australia is now going further. A new "Outcome Test" will be adopted for trustees of superannuation schemes as well as increased powers for the pension regulator. The Outcome Test expands the current 'scale test' with a two-stage test that requires trustees to undertake an annual determination considering a number of additional features in addition to the scale criteria to ensure that the default outcomes being delivered are in the financial interests of their MySuper members. This is to ensure that any schemes with scale but which are still delivering poor returns are under pressure to exit.

The problems with trust based DC are the result of poor execution and those problems are best resolved through scale. There are policy options available to resolve these issues based on best practice overseas.

Questions

Question 1: Do you believe there is a gap in the FCA's existing regulatory framework that could be addressed by introducing a New Duty, whether through a duty of care or other change(s)? If you believe that there is, please explain what change(s) you want to see. We are particularly interested in your views on:

i. The types of harm and/or misconduct any changes would address.

Based on an analysis of the legal structure and incentives operating in the two halves of the pension market, fiduciary duty is a superior governance standard and the market should be aligned at that standard.

The differential effect of different forms of governance can be seen in outcomes: both in prices and in the products made available.

DWP data shows that the mean cost of membership to a member in a master trust is 0.45% AMC. The mean cost of membership of a contract-based scheme depends on the size of the employer (which is interesting given that the contract is nominally supposed to be with the individual). For employers with 1-5 employees, the mean AMC is 0.72%; 6-11 employees, it is 0.69%; 12-99 employees, 0.65%; 100-999 it is 0.56% and over 1000, it is 0.45%[15]. (Note that 50% of UK private sector employment is with firms that employ fewer than 50 people[16]).

Behaviour in the retirement market is highly illustrative as to what happens to product offering when provider and member interests are not aligned.

With respect to annuities, contract-based providers do not provide neutral whole-of-market annuity brokerage, presenting members with the best available deal. This is despite that fact that the evidence from Chile is that this is how best value for money for members can be achieved[17]. The FCA has forced contract-providers to include more information as to alternative product offerings but this is a far weaker obligation than the providers taking responsibility and directing members to the product which is actually best for them. The FCA's own research found that 80% of people would benefit from switching but the enhanced prompt only increases switching from 7 to 25%[18].

We are currently building a hybrid drawdown-annuity product for members. The annuity offer will be built on the best price we can negotiate from the market for members using the aggregated demand from our members. We will pass on the institutional price we will be able to negotiate. Our understanding is that other trust-based schemes will do something similar.

Similarly, with respect to drawdown, contract-based providers are often charging very high prices, similar to the prices that they charged for cumulation products prior to the price-cap. The FCA's retirement outcomes review identified a spread of between 40-160 basis points for substantially similar "vanilla" drawdown products. B&CE is deep in drawdown product design for The People's Pension and we can see no objective justification for such prices. We note that the FCA is currently proposing to rely on information remedies combined with a possible extension of IGC jurisdiction to retirement products to try and align incentives. There is no reason to believe that these measures will prevent rent—seeking in this market. Many customers will, in practice, end up defaulting into their provider's product.

---

[15] See table 3.3. in https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/652086/pension-charges-survey-2016-charges-in-defined-contribution-pension-schemes.pdf

[16] House of Commons Library, Briefing Paper Number 06152, 28 December 2017 Business statistics, p.5.

[17] The most recent academic paper is THORBURN, Craig. et al. (2007) "An Analysis of Money's Worth Ratios in Chile". Cambridge: Journal of Pension Economics and Finance 6 (3): 287-312. However, the Chilean *Fiscalía Nacional Económica* used the MWR as the basis for its detailed assessment of the Chilean annuity market and carried developed MWR "new" ratios for the period 2008 to 2017; see: Page 93. FNE - Estudio de Mercado sobre Rentas Vitalicias (EM01-2017) – Santiago – Informe Final - febrero de 2018.

[18] https://www.fca.org.uk/publication/consultation/cp16-37.pdf, p.26

The difference between IGC governance and the governance of trust-based organisations can be illustrated in practice by our support for an extension of the price cap to drawdown to protect members. We are unaware of any "independent" IGC which has publicly made such a statement.

Lack of alignment may also explain why contract-based schemes have been happy to sell existing drawdown products designed for an affluent market to all members reaching retirement. It seems obvious to us as an organisation that is designed to act pro-actively in the member interest that mass market retirees will need hybrid products that include longevity protection.

ii. Whether a New Duty should be introduced and, if so, what form it should take.

For the reasons set out above, we believe that the relationship between an individual saving in a workplace pension and their provider should be a fiduciary one. In the introduction we set out several reasons why we believe that a fiduciary duty should be required. First, we believe that fiduciary duty will deal with issues of agency and motivation that harm the interests of savers in UK workplace pensions. We believe that fiduciary duty is the best way to address these issues. Second, we believe that a duty of care would be a weaker lever for improvement. A duty of care provides a lower bar for provider behaviour, as it may be assessed against market practice. A duty of care also speaks more to issues of competence and less to motivation, which we see as the primary issue.

iii. What additional consumer protection and benefit this would provide, above the current regime (including over and above the existing implied term in the CRA for reasonable care and skill).

Reasonable care and skill pertain to the competence with which duties are performed. As previously stated, we believe that contract-based workplace pensions suffer from a problem of competing motivations and not a problem of competence. We see fiduciary duties as a way of avoiding a significant conflict of interest between savers and those governing a scheme.

iv. How a New Duty could and should act to mitigate or remove conflicts of interest, including the types of conflicts which exist in the provision of financial services?

A requirement for all workplace schemes to be provided on a trust basis would mean that schemes had to proactively operate in the best interests of their members. Trustees would be informed by the rich and long-established UK case law on trust law. If they failed to meet it, they would create a legal exposure for themselves. A fiduciary duty excludes the conflicts of interest which are permitted for members of IGCs.

Contract-based providers seem confident that if they are operating with the established norms of the contract-based pension industry then they are not at risk from any breach of duty of care and that they are not at risk of FCA enforcement action either. The COBS rule 2.1.1R that a firm should act "honestly, fairly and professionally in accordance with the best interests of its client" may be being interpreted as a requirement not to actively do harm rather than a requirement to proactively act in the best interests of the member: a requirement to act in the best interests of the "client" can potentially be interpreted very differently from a requirement to act in the best interests of the "beneficiary". As a result, it may then follow that some contract-providers believe that the obligation can be met by providing the member with information to (nominally) facilitate switching rather than by acting to provide a product best suited to the member. All of the major changes in consumer protection in contract-based pensions in the last five years which have had a material positive effect on outcomes have to date been a consequence of legislative action, they have not followed from either any FCA or any legal activities.

In this sense, if we consider COBs 2.2.1R as a duty of care rule, the characterisation that the FCA are suggesting of a duty of care as being a "positive" duty is not evidenced by what has actually happened on the ground.

v. Whether a New Duty could reduce complexity and bring greater clarity, or whether it could result in an additional layer of regulation and make it more complex, and, if so, how?

Fiduciary duties are well understood across the pensions landscape and are backed by a considerable volume of case law. Around £1.5tn of pension assets are managed under this governance standard. Furthermore, many contract based workplace pension providers are already operating a master trust pension scheme alongside their GPP. As such, most would be well placed to cope with the imposition of a new duty.

Industry opponents of the extension of fiduciary duty to contract based pensions sometimes argue that this would comprise of retrospective legislation and that this is something UK governments generally seek to avoid. This argument is flawed. The issue can be clarified using the example of a government budget setting a hypothetical increase in income tax. A retrospective tax increase would mean the government would apply the tax increase to salary received prior to the budget. Absent the invention of time travel, it is impossible for the governance of workplace to change in the past. Changing the governance of workplace pensions going forward is exactly the same as adopting any other form of social or economic regulation. Our hypothetical income tax payer cannot argue that he took his job ten years ago on the basis that future tax would always be at 40% and that the new 42% rate should only apply to people taking new jobs.

vi. Whether other alternatives could help address any gaps, for example, extending the clients' best interests rule to different activities.

As discussed above, the clients' best interest rule is already in place in workplace pensions. We do not see it as being effective given the way it appears to be being interpreted. Different wording or a legislative prescription would be required to create a fiduciary duty. The duty would have to clearly apply to beneficiaries.

We note that in recent regulatory battles in the US, regulators have sought to impose fiduciary duties whereas the financial services industry has preferred "best interests" because it has taken the view that this can permit a lower standard of conduct.[19]

vii. Whether we should introduce more detailed rules and guidance, and, if so, what specific rules and guidance are required?

The materials already exist as regards the operation of trustees in a workplace pension scheme.

viii. Whether the scope of any changes should differ between markets and whether it should include wholesale transactions.

Our set of responses are tailored specifically to the workplace pension sector.

Question 2: What might a New Duty for firms in financial services do to enhance positive behaviour and conduct from firms in the financial services market, and incentivise good consumer outcomes?

The imposition of a fiduciary duty on workplace pension providers would lead to a culture change within those providers as the balance of incentives present in firms would change. We already observe the difference in practice in the behaviour of different types of providers with respect to consumer interests and in outcomes. A duty to act in the best interests of beneficiaries would improve outcomes for consumers. This is not a hypothetical solution in the UK, we can already observe the differences as we have both sets of providers already in operation.

Question 3: How would a New Duty increase our effectiveness in preventing and tackling harm and achieving good outcomes for consumers? Do you believe that the way we regulate results in a gap that a New Duty would address?

Yes, introducing a fiduciary duty and trustee governance for workplace pension providers would result in contract-based providers applying principles-based governance themselves. This is because unlike the FCA's COBs principles, fiduciary duty is directly legally enforceable.

It would likely result in the FCA having to focus less on the micro-regulation in areas such as how information to customers should be disclosed, levels of charging and pension product design.

---

[19] https://www.investmentnews.com/article/20180410/BLOG07/180419991/best-interests-and-fiduciary-arent-the-same-so-which-will-the-sec

Question 4: Should the FCA reconsider whether breaches of the Principles should give rise to a private right for damages in court? Or should breaching a New Duty give this right?

If a fiduciary duty were imposed on contract-based providers, then their customers would have the right of redress through the courts. This is well understood in the context of pensions and there is a large advisory industry capable of supporting providers in handling it. Indeed, as previously observed, many providers also operate a master trust pension scheme and are already exposed to this risk.

Question 5: Do you believe that a New Duty would be more effective in preventing harm and would therefore mean that redress would need to be relied on less? If so, please set out the ways in which a New Duty would improve the current regime.

Yes, because fiduciary duty is principles based and directly enforceable by individuals, the principles do not need to be turned into detailed rules in specific areas by the FCA before it has any effect.

By pursuing behavioural micro-regulation targeted to specific problems, the FCA is always one step behind the problem. Where providers have an institutional structure that encourages rent-seeking and there is weak buyer power, abuse will continuously reoccur in new forms as markets innovate.

The problem with this for the market as a whole is that it damages pension saving. As the FCA noted it in its recent investigation into retirement outcomes, the pension industry is highly mistrusted20. This is now the fourth decade since the pension industry began self-sabotaging and, as a country we have not yet built a regulatory system that helps us to all work together to restore its reputation.

For further information on this response, or the work of B&CE and The People's Pension, please contact: Tim Gosling, Head of Pensions Policy at timgosling@bandce.co.uk or 07824 144152

[20] https://www.fca.org.uk/publication/market-studies/ms16-1-3.pdf p.21.