

INDEPENDENT GOVERNANCE COMMITTEES: EXTENSION OF REMIT

CP 19/15: PLSA RESPONSE

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THE PLSA

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

INTRODUCTION

The PLSA believes that the FCA's proposals set out in the consultation represent a positive step forward and could result in improved member outcomes. However, we are concerned that the FCA is placing more responsibility on IGCs without equipping them with the necessary powers required to ensure providers take account of their views. The obvious parallel in this regard is the trust-based sector. The present proposals create a higher degree of equivalence between trustee and IGC responsibilities, but retain the lack of equivalence between trustee and IGC powers. This divergence in powers could have a material impact on consumer outcomes.

The PLSA supports the FCA's proposals to extend the remit of IGCs to include explicit consideration of a firm's policies on environmental, social, and governance issues, as well as consumer concerns and matters relating to stewardship. All long-term investment and savings products require a long-term approach to decision-making, including consideration of financially material environmental, social and governance (ESG) and stewardship approaches, therefore it is appropriate for IGCs to examine firms' policies relating to them.

Moreover, where possible, we believe rules for contract-based schemes should achieve equivalent protection for members as those placed upon trust-based schemes to ensure consistency across the pensions industry. Given the DWP's 2018 changes to the *Occupational Pension Schemes (Investment) Regulations 2005* to clarify how trustees can take account of financially material ESG factors similar changes should be required for contract-based schemes so that members of all types of pension scheme arrangements receive similar information. This is consistent with regulators' desire for consumers to receive equivalent treatment.

Although we have specific concerns about the design and durability of investment pathways, which we set out in our response to CP 19/5, they represent an important first step in improving saver outcomes in the at-retirement market. To ensure that savers derive the maximum value from investment pathways, we support the FCA's proposals for a new duty to be placed on IGCs to oversee their value for money.

The focus on value for money throughout the decumulation phase is crucial, particularly in drawdown, as decisions during this phase have a significant impact on savers' outcomes. Although we agree that it will be important to assess the value for money of investment pathways during the initial design phase and before they are offered to consumers, the real question (not addressed by the consultation paper) is how IGCs would go about doing this. We do not believe that the FCA should prescribe the process IGCs should go through to assess the initial design of pathways solutions, though it could provide IGCs with guidance to ensure pathways meet consistent standards.

In our *Hitting The Target* report (2018), we recommended that the pensions sector should develop new value for money metrics to help schemes and providers make comparisons.¹ Such metrics would apply as much to the decumulation phase as the accumulation journey. We look forward to working with the FCA and the TPR, as well as the pensions industry, to achieve further progress in this area.

¹ PLSA, *Hitting The Target: A Vision For Retirement Income Adequacy* (2018).

CONSULTATION QUESTION RESPONSES

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?

We welcome government’s commitment to support schemes considering financially material ESG issues in their investment decision-making. There is a growing body of evidence to demonstrate that incorporating ESG considerations into investment strategies could have a positive impact on long-term risk-adjusted returns.

Pension schemes are long-term investors and ideally placed to act as stewards of beneficiaries’ money. Seventy nine per cent of schemes in our January 2019 stewardship survey stated that they took stewardship considerations into account in manager selection and 73 per cent told us that they believe ESG factors are financially material to company performance.

We believe rules for contract-based schemes should mirror those placed upon trust-based schemes, as far as is possible and appropriate, so that members of both kinds of pension scheme arrangement receive similar benefits and protection. Moreover, we think that further clarification is needed that ESG considerations present opportunities as well as risks. Given that this will be a new area of consideration for many IGCs, this should be supplemented by detailed FCA guidance, including signposting to other industry resources, to help IGCs meaningfully assess the adequacy and quality of providers’ ESG and stewardship policies. Our recent guidance *ESG and Stewardship: a practical guide to trustee duties*², while aimed at trust-based schemes, offers many practical examples and suggestions that would also be of relevance to IGCs.

Messaging around member concerns must also be aligned with DWP’s language on this issue (with regards to their “optional policy statement” on non-financial factors, including member views). It is important recognise that member concerns are important, though they are not the primary driver of investment decisions.

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

We think it is important that rules for contract-based schemes achieve equivalent protection for members as those placed upon trust-based schemes. In light of DWP’s recent changes in this area, similar changes should be required for contract-based schemes so that members of all types of pension scheme arrangements receive similar information. This is consistent with regulators’ desire for consumers to receive equivalent treatment. The new regulations should be accompanied by guidance from the FCA regarding what kind of information contract-based schemes should consider including in their implementation statements.

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

We believe that this is both appropriate and desirable. A 2018 survey of fund managers by the UK Sustainable Investment and Finance Association (UKSIF) found that 90% of fund managers expect

² This can be found online at www.plsa.co.uk.

that the valuation of companies in the oil and gas sector will be impacted significantly within the next two years because of climate-related risks.

We welcomed the DWP's inclusion of specific references to "appropriate time horizons" in its changes to the investment regulations and believe it would make sense for the FCA to introduce a similar clarification through its regulations: all pension scheme arrangements should be encouraged to think about what ESG or stewardship approach best works for their scheme's objectives and circumstances, including the period of time over which their investments are held.

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

We agree that reports should be placed in a prominent position on the firm's website and signposted to clearly. We agree that previous years' reports should also be made publicly available.

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?

All long-term investment and savings products require a long-term approach to decision-making, including consideration of financially material environmental, social and governance (ESG) issues and stewardship approaches. As a result, it is our view that guidance to clarify how firms should think about ESG risks, not to mention opportunities, and how they should act as good stewards of their assets, would be helpful for all firms that provide pension products and all life insurers which provide investment-based life insurance products.

The FCA should ensure it is clear on how the proposed guidance in this respect aligns with the new Shareholder Rights Directive (SRD II) duties upon life insurers. We are aware that both contract-based and trust-based schemes face challenges in getting to grips with how SRD II duties interact with other new requirements in this space (i.e. the 2018 changes to the *Investment Regulations* for trust-based schemes) and the consultation paper's proposals for IGCs.

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

We agree that it is appropriate for the FCA to focus its requirements for an IGC primarily on firms offering pathway solutions to consumers. However, we are concerned about the relationship between the firm offering the pathway and the firm manufacturing the pathway in instances where these organisations are not one and the same.

In particular, the fact that an IGC in this situation will not be able to challenge the product manufacturer directly (but only through the provider to which it is linked) introduces a degree of unnecessary complexity into the value for money review process providers' IGCs will be required to undertake in regard to the products offered to consumers.

Ideally, the relationship between the product provider's IGC and the product manufacture would be direct. This would help to ensure that IGCs' concerns about product design, where they exist, are effectively communicated and taken into account properly.

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

In our response to CP 19/5, we raised our concerns about the FCA's approach to the treatment of providers with smaller numbers of non-advised consumers entering drawdown. Specifically, we stated our belief that the FCA will need to monitor the use of the proposed easement for smaller providers to ensure that it is not being abused.

For example, we are concerned that a corporate parent might be able to circumvent these rules by setting up subsidiary advisers, each of which could be limited to less than 500 non-advised consumers. In this case, each subsidiary would qualify for the easement even though the corporate group could have a much larger number of non-advised consumers. We remain concerned about this and would like the FCA to set out how it plans to prevent this sort of behaviour from taking place.

The FCA's proposed alternative to an IGC for providers offering drawdown pathways to a smaller number of non-advised consumers – Governance Advisory Arrangements (GAAs) – might be an appropriate solution to ensure that savers are accessing drawdown products that have been selected using good governance processes. However, the FCA's rationale for suggesting GAAs appears to be cost-based. We believe that this is the wrong focus. The test, particularly in the context of the concerns we expressed in CP19/5 (repeated above), should be the likely impact of using such arrangements (vs. an IGC body) on savers' outcomes.

The FCA has not presented this sort of comparative analysis in the present consultation paper and we believe this is necessary to form a considered view on the appropriateness of using GAAs instead of IGC arrangements.

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

In our *Hitting the Target* report (2018), we recommended that a new decumulation framework should be adopted in which an independent body (a trustee or IGC) would select a suitable product/solution for members. The product or solution selected should be appropriate to the membership of the scheme as a whole.³ We believe, therefore, that IGCs should play an important role in signposting non-advised consumers to good quality decumulation pathways.

In terms of IGCs' role in product design or licensing, we recognise that there are conflicting arguments regarding their function in this process. On the one hand, the considerable experience members of IGCs can bring to bear means that they could certainly be considered informed stakeholders and would offer valuable feedback to providers regarding the suitability and value for money of initial pathway solutions. On the other hand, this function would represent a fundamental change in the role of IGCs and their relationship with providers. IGCs might find it difficult to build the capacity required to perform the additional function of assessing pathways in the time allowed (i.e. by July 2020 – the FCA's proposed date for the introduction of investment pathways).

On balance, we agree that when a firm has decided to offer pathway solutions it would be reasonable to expect it to have an IGC in place to feed into the initial design of those solutions. However, the

³ PLSA, *Hitting The Target: A Vision For Retirement Income Adequacy* (2018).

real question is how IGCs would go about doing this. We do not believe that the FCA should prescribe the process IGCs should go through to assess the initial design of pathways solutions, though it could provide IGCs with guidance to ensure pathways meet consistent standards.

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?

We welcome the proposed extension of IGCs' value for money obligations to the decumulation phase. The value for money assessment currently undertaken by IGCs has proved to be a useful means of improving savers' outcomes.⁴ The PLSA would welcome greater clarity from both the FCA and TPR about their expectations in relation to the assessment of the value for money of investment pathways. The FCA/TPR joint strategy highlighted value for money assessment as a key area of collaborative work for the regulators and we agree that this should take place as soon as possible.⁵

While we agree with the view expressed in the paper that there can be additional complexities and risks in the decumulation phase, compared to the accumulation phase, in assessing value for money, this should not deter the regulators (and the pensions industry) from seeking a solution. If the remit of IGCs' were to continue to comprise accumulation alone, this would leave a significant gap in their oversight during a period when decisions taken can often have a critical impact on retirement outcomes.

The proposal in the consultation paper is to introduce new rules in COBS 19.5.5 that determine how IGCs should assess value for money for pathway investments. The draft rules follow a similar structure to the existing rules in COBS 19.5.5 for IGCs to assess value for money during accumulation, substituting an assessment of default investment strategies with an assessment of 'pathway investments'.

Requirements for an IGC to assess value for money include a requirement to consider:

1. Whether the pathway investments are designed and managed in the interests of pathway investors;
2. Whether they have clear statements of aims and objectives; and
3. Whether the characteristics and net performance of pathway investments are regularly reviewed by the firm.

We believe these are sensible checks for an IGC to undertake. However, we also note that they do not alone form an assessment of the quality of a pathway investment. For example, it would be possible for the aims and objectives of a pathway investment to be clearly stated and yet still represent poor value for money. Similarly, a regular review could be conducted by a firm, but to a poor standard.

In our response to CP19/5, we signalled that we believed the FCA's proposed approach to developing pathway solutions was a step in the right direction. The process of designing pathway solutions

⁴DWP/FCA, *Remediating Poor Value Legacy Workplace Pension Schemes* (2016).

⁵FCA/TPR, *Regulating the pensions and retirement income sector: our joint regulatory strategy* (2018).

entails an assessment of their value for money, which means that any pathway investment should already have passed such an assessment. The consultation paper says little, during the discussion at paragraph 5.24, about the planned further work on value for money in workplace pension schemes. The PLSA supports further work in this area and would welcome the opportunity to comment in more detail at a later date.

We believe there is scope to develop a value for money assessment that is suitable for both the accumulation and decumulation phases. In *Hitting The Target*, we recommended that the pensions sector should develop new value for money metrics to help schemes and providers make comparisons, and we look forward to working further with the FCA and the TPR, as well as the pensions industry, in this regard.⁶

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

In principle, we agree that what constitutes value for money changes over time (for example, as costs decrease and quality increases for a given type of product, or with changing market conditions). However, we do not believe that a comparison should only be made with products currently in the market in cases where a consumer is not locked into a contract (and has the option to switch). Otherwise, an appropriate comparator would be with legacy products sold at the time a contract was originally made.

⁶ PLSA, *Hitting The Target: A Vision For Retirement Income Adequacy* (2018).

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