Securing the future of pensions

FCA Consultation Paper on proposed rules for independent governance committees: a response by the National Association of Pension Funds

October 2014

Contents

Executive Summary

NAPF strongly support the Government and FCA's focus on improving governance arrangements in contract-based workplace pensions. With the introduction of automatic enrolment, it has become even more important that contract-based pension schemes have independent governance arrangements in place to make sure they are run in the interest of members.

However, whilst we support the focus on better governance, we do have reservations about the extent to which Independent Governance Committees (IGCs) will be able to influence the behaviour of pension providers. IGCs will play mostly an advisory role rather than having direct powers like trustees, and pension providers' have responsibilities to their shareholders.

To inform our response to this consultation, NAPF has conducted a short survey of NAPF members and Pension Quality Mark (PQM) schemes to find out their views on IGCs. The survey targeted employers running contract-based schemes, and found that:

- Three quarters of respondents supported the creation of IGCs, with only 10% opposed;
- 85% of respondents agreed that IGCs need to oversee deferred members; and
- Respondents were almost evenly split on whether they thought that providers would listen to IGCs' concerns.
- Respondents believe that value for money, member communications and investment performance should be the top three priority issues for IGCs.

Based on these views, our response makes four key recommendations:

1. As the effectiveness of provider-level governance committees is completely untested **there should be a formal review of the effectiveness of IGCs after they have been in operation for 2 years**. This review should be completed so that any changes to the rules can be made by April 2018.

2. The consultation makes no mention of how IGCs should relate to employer-level management and governance committees, which have been set up with the encouragement of the Pensions Regulator and PQM. **IGCs should be strongly encouraged to identify and make contact with all governance committees run by employers using their provider, and should set up a mechanism for listening to their views on the service being provided.**

3. IGCs need to develop an independent culture and practice to be able to see a different perspective from their provider's in-house view. **The FCA should encourage IGCs from different providers to collaborate, to develop and share good practice and build common frameworks for assessing and benchmarking provider value and performance.**

4. Those involved in running workplace schemes on the ground believe that IGCs should focus on issues wider than just the 'value for money' items that the consultation proposes should be mandated. **The FCA should make it explicitly clear that IGCs can consider all issues that make a difference to members, including member communications, administration, and support for members approaching retirement.**

Overview of NAPF response

Introduction

1. The NAPF is the voice of workplace pensions in the UK. We speak for over 1,300 pension schemes that provide pensions for over 17 million people and have more than £900 billion of assets. We also have 400 members from businesses supporting the pensions sector. We aim to help everyone get more out of their retirement savings. To do this we spread best practice among our members, challenge regulation where it adds more cost than benefit and promote policies that add value for savers.

2. We strongly support the Government and FCA's focus on improving the governance arrangements in contract-based workplace pensions. With the introduction of automatic enrolment, employees can spend a lifetime saving into a workplace pension, which was set up by their employer and which they never made an active choice to join. Contract-based pension schemes need to have independent governance arrangements in place to make sure they are run in the interest of members.

Are Independent Governance Committees the right solution?

3. Whilst we support the focus on governance, we do have some skepticism about the extent to which Independent Governance Committees (IGCs) will be able to influence the behaviour of pension providers. IGCs will play mostly an advisory role rather than having direct powers like trustees, and pension providers' have responsibilities to their shareholders.

4. As the effectiveness of provider-level governance committees is completely untested, the FCA will need to actively monitor their development in the first few years to make sure they are being taken seriously and properly resourced. One key difficulty for IGCs will be the sheer variety of different arrangements they will be overseeing, with scheme members being charged different amounts and having different investment strategies depending on the employer that enrolled them.

5. **NAPF strongly believes there should be a formal review of the effectiveness of IGCs after they have been in operation for 2 years. This review should be completed so that any changes to the rules can be made by April 2018.**

Employer-level governance committees

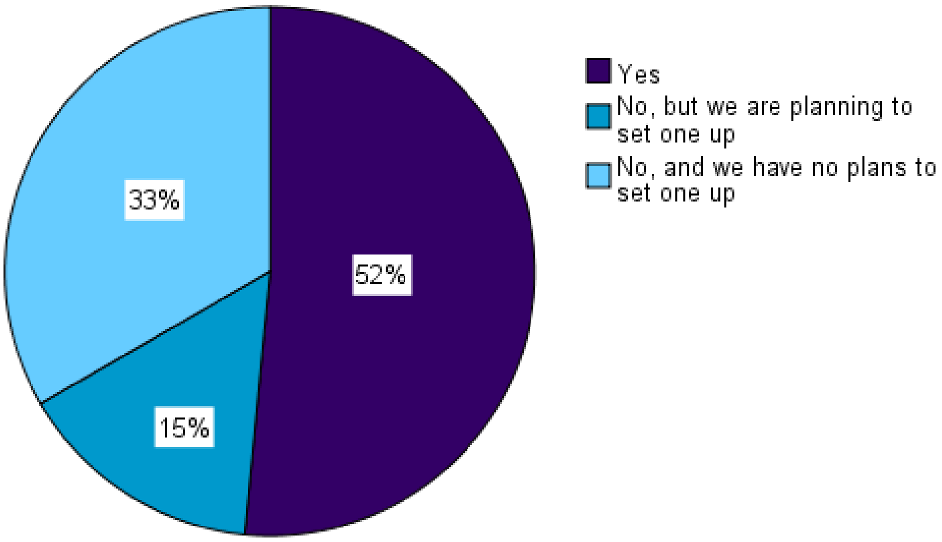
6. NAPF has long recognised that there is a 'governance gap' in most contract-based workplace pensions. To combat this, we have encouraged employers who use contract based pensions to set up their own management or governance committees. Such committees are different to IGCs

in that they monitor an individual employer's arrangement with a pension provider and advise the employer not the provider.

7. In 2009 we launched Pension Quality Mark (PQM) to accredit well-run workplace pension schemes, and one of the key requirements is for contract-based schemes to have governance arrangements to make sure the scheme is being run with members' interests in mind. Management committees are the most common way for employers to do this. Since 2008, the Pensions Regulator has also encouraged employer governance committees through its voluntary guidance 'Monitoring your pension scheme: management committees for employers' which was re-published in 2013[1].

8. NAPF's last annual survey (2013) found that two thirds of the contract-based schemes that responded either had a governance committee or were planning to set one up. Of the committee's that were already set up 96% had employer representatives, 69% member representatives and 22% independent members.

NAPF annual survey 2013: Does your scheme have a governance committee? (99 respondents)



9. Therefore we are quite surprised that there is no mention of how IGCs should relate to these employer-level committees. NAPF recently conducted a further survey with a small number of employers running such committees to find out their attitudes to IGCs. Of the 13 respondents, 12 believe that their providers' IGC will be no substitute for the work their committee does at an employer level. 11 of the 13 employers said that they would expect there to be dialogue between their governance committee and their provider's IGC. Employers reported that the key issues that their committees focus on are member communications, investment performance and administration.

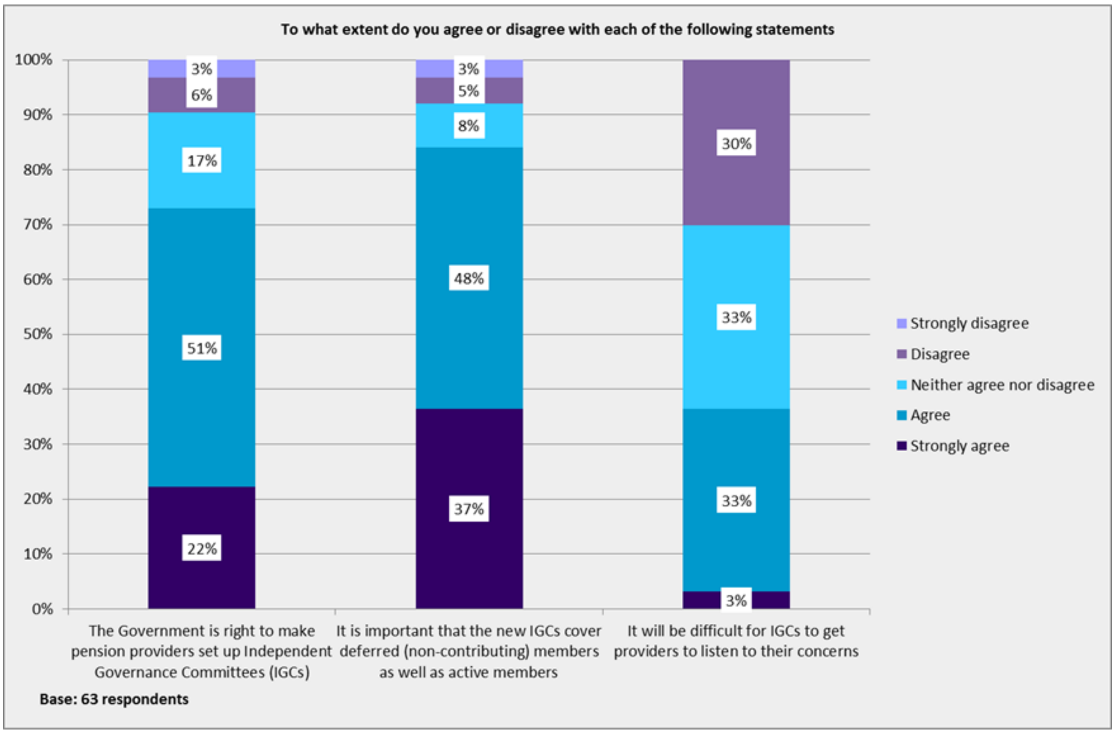
[1] http://www.thepensionsregulator.gov.uk/docs/employer-management-committees.pdf

10. Such committees are voluntary and only run by more engaged employers, who usually have larger workforces. There is no central register of such committees; however we would estimate based on our annual survey that there are several hundred employers running one. These committees could play an important role in feeding into IGCs, making schemes aware of the concerns of those on the ground.

11. **<u>IGCs should be strongly encouraged to identify and make contact with all governance committees being run by employers using their provider, and to set up a mechanism for listening to their views on the service being provided.</u>**

How should Independent Governance Committees work?

12. At the end of September, NAPF and PQM conducted a short survey of NAPF members and schemes that hold PQM to find out their views on IGCs. The survey was targeted at those with an interest in governance committees and two thirds of the 73 respondents were involved with running a contract-based scheme for their employer. The key results are:
    - Almost three quarters of respondents agreed that the Government was right to make pension providers set up IGCs. Only 10% were opposed, with the main reason being a fear they would be costly and/or bureaucratic.
    - 85% of respondents agreed that IGCs need to cover deferred members.
    - The jury is out on whether IGCs will be able to influence providers. Just over a third of respondents thought that IGCs will struggle to get providers to listen to their concerns, but almost a third disagreed and thought this would not be a problem.

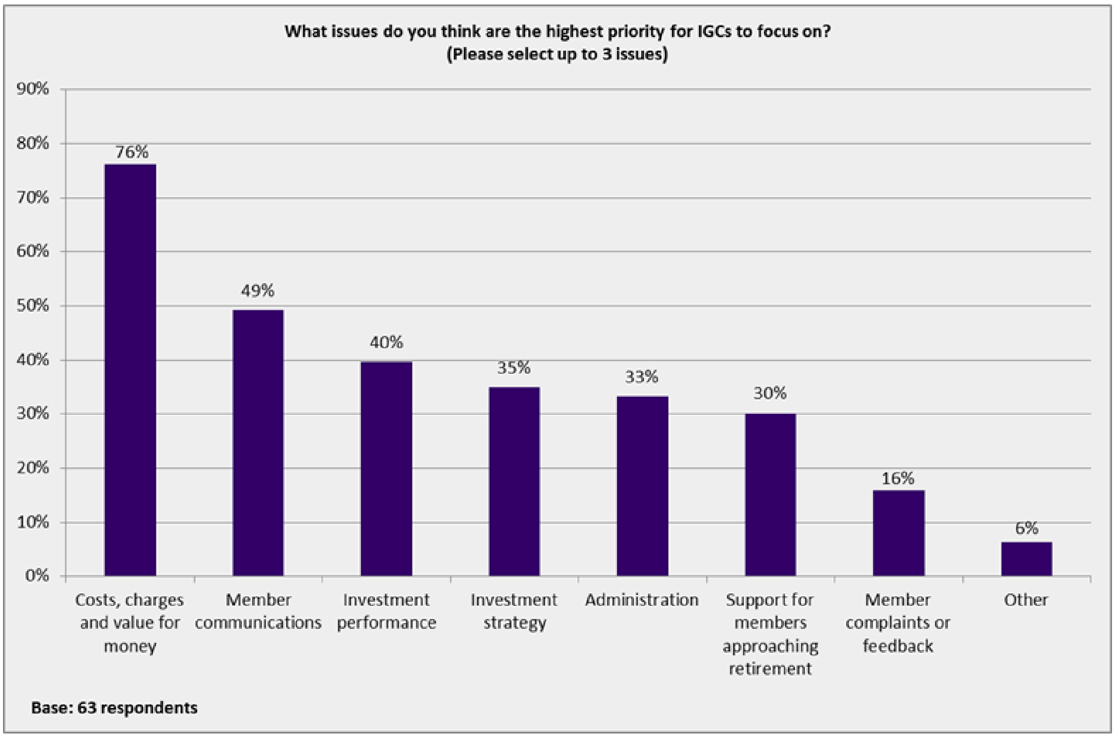


13. Our detailed responses to the consultation questions are set out in the following section. Rules around the independence, appointment and number of committee members have a role to play in ensuring IGCs are effective. However, even more important is the independent culture and practice they need to be able to see a different perspective from their provider's in-house view. IGC members from different providers need to be able to come together to develop and share good practice, as trustees currently do. Indeed, there should be opportunities for trustees and IGCs to share good practice and, for instance, to develop common frameworks to assess and benchmark good value and good quality. NAPF would be willing to play a role in facilitating such dialogue, and has experience of bringing schemes and providers' together, whilst being mindful of competition law requirements and commercial confidentiality.

14. **The FCA should encourage an independent culture amongst IGCs, and collaboration to develop and share good practice and to build common frameworks for assessing and benchmarking provider value and performance.**

What issues should IGCs cover?

15. Our survey also asked NAPF members and PQM holders what one to three issues they thought were the most important for the new IGCs to focus on when they are set up. The top priority was 'costs, charges and value for money' with 76% picking this. The second priority was scheme member communications which was selected by half of respondents and investment performance was third (40% of respondents).



16. These responses show that those involved in running workplace schemes on the ground believe that IGCs should focus on issues wider than just the 'value for money' items that the consultation proposes should be mandated. Whilst clearly prioritising costs, charges and value, respondents to our survey said IGCs should also focus on other issues that really affect members, such as communications and administration. Therefore, we welcome the FCA's proposal to allow IGCs to interpret their value for money brief widely, and potentially cover the issues above. However, we believe that this could be made more explicit, so it is clear to providers that IGCs should be entitled to look at issues like the quality and effectiveness of member communications, and the information and support that members receive at retirement.

17. **The FCA should make it explicitly clear that IGCs can consider all issues that make a difference to members including member communications, administration, and support for members approaching retirement.**

Response to specific consultation questions

Q1: We would welcome views on the likely equality and diversity impacts of the proposed rules.

We believe the effectiveness of IGCs should be reviewed by April 2018; this review could include an assessment of whether a diverse range of different people are involved in IGCs.

Q2: Do you agree that deferred members of workplace personal pension schemes should be within the mandatory scope of IGCs?

Yes – this is essential. Deferred members often have the weakest voice as the employers who select the provider are understandably most interested in the active members who are their current employees. 85% of respondents to our survey on IGCs said that they should cover deferred members.

Q3: Do you agree that individual personal pensions, other than those that originated as workplace personal pensions, should not be in the mandatory scope of IGCs?

Yes. The primary purpose of IGCs should be to protect scheme members who had no choice in provider as it was selected by their employer, so it should not be mandatory to cover pensions that were purchased individually. However, in practice, some providers may find it easier for their IGC to cover all the pensions they manage, as separating out the origins of the different pots could be complex and time consuming. So this all-encompassing approach should be allowed also.

Q4: Do you agree that individual personal pensions should not be in the mandatory scope of IGCs even where the employer contributes or facilitates payments?

Yes. Although, as stated above, providers may well consider covering all pensions.

Q5: Do you agree with our proposals for which firms will be required to establish and maintain an IGC?

Yes.

Q6: Do you agree that IGCs may be established at a group level?

Providing governance at scale makes sense and reduces costs for members – so we would support this in principle. However, providers will need to make sure that their IGC has the resources to oversee a large and complex group of different arrangements. IGCs will need to understand the diversity of schemes, employers and members they are representing.

Q7: Do you agree that an IGC must have a majority of members independent of the firm and that the IGC Chair must always be independent?

Yes – this is essential. NAPF pushed for this requirement on master trust boards for a number of years, and made it a requirement of its Pension Quality Mark rules for master trusts.

Q8: Do you agree that an IGC should have at least five members?

We are not sure it is necessary to be too prescriptive on numbers and think any figure should be kept under review to see how the IGCs work in practice.

Q9: Do you agree with our proposed definition of independence that would allow trustees of a firm's master trust to be independent IGC members?

This seems to be sensible, but should be kept under review to see how it works in practice.

Q10: Do you agree that we should not require firms to indemnify IGC members?

No. We believe that IGC members should be indemnified. Whilst we recognise that it is not clear what exposures there might be, we endorse the conclusions of the Law Commission that indemnification is necessary to ensure sufficient numbers and quality of individuals come forward to act as IGC members.

Q11: Do you agree that members of the IGC, including the IGC Chair, should not be approved persons at this time?

Yes, however, FCA should set a timescale for this to be reviewed rather than leaving it vague. We believe that a review should be completed and changes implemented by April 2018.

Q12: Do you agree that we should require firms to recruit independent IGC members through an open and transparent recruitment process?

Yes, as the IGCs' powers are limited and members are appointed by the provider it is essential the recruitment is as transparent as possible. However, we do not believe the FCA should be too prescriptive in specifying how providers achieve this openness and transparency in their recruitment. Providers also need to be recruiting individuals now to get IGCs up and running by April, and FCA should not do anything that holds up this progress.

We agree that there should be no requirement for IGC's to include directly elected scheme members. This is impractical in many cases and there are often better ways of engaging with members and ensuring a wide range of members views are considered. Please see our response to Q27 for more detail on this point.

Q13: We would welcome views on the proposed duration of appointment of IGC members.

We are pleased the term limit has increased to two terms of five years - stability and experience are essential for good governance. IGCs will want to ensure that terms are staggered to help ensure continuity.

Q14: Do you agree that we should permit the appointment of corporate persons to IGCs, including as the IGC Chair?

Yes.

Q15: Do you agree that there should be no restriction on the duration of a corporate appointment?

Yes – with the proviso that the individual should be rotated.

Q16: Do you agree that IGCs should consider in particular the value for money received by individuals enrolled in default funds?

Yes – it is very important that IGCs focus on default funds, especially as the vast majority of members are saving in defaults and member engagement is low.

Q17: Do you agree that, at a minimum, IGCs must assess whether the characteristics and net performance of all investment strategies are regularly reviewed by the firm?

Yes.

Q18: Do you agree that, rather than mandating a particular approach, we should allow individual IGCs to determine how best to assess value for money?

Yes – but the FCA should encourage IGC members from different providers to come together to develop and share good practice, as trustees currently do. In particular there should be opportunities for trustees and IGCs to develop common frameworks to assess and benchmark good value and good quality. NAPF would be keen to play a role in facilitating such dialogue.

Q19: Do you agree that IGCs should be required, at a minimum, to review the three aspects of scheme quality proposed, and should consider other aspects as appropriate?

The responses to our survey show that those involved in running workplace schemes on the ground believe that IGCs should focus on issues wider than just the 'value for money' items that the consultation proposes should be mandated. Whilst clearly prioritising costs, charges and value, respondents to our survey said that IGCs should also focus on other issues that really affect members, such as communications and administration. Therefore, we welcome the FCA's proposal to allow IGCs to interpret their value for money brief widely, and potentially cover the issues above. However, we believe that this could be made more explicit, so it is clear to providers that IGCs should be entitled to look at issues like the quality and effectiveness of member communications, and the information and support that members receive at retirement.

Q20: Do you agree that IGCs should consider all costs and charges, as proposed? If not, what would you suggest?

Yes - we do not believe that the role of IGCs should be unhelpfully constrained. Clearly this will require a full breakdown of costs from fund managers and other providers, and the FCA have an important role in making sure this information is provided.

Q21: We would welcome views on how best to improve the disclosure of all costs and charges, and how we could transpose the industry standards for authorised funds to pensions.

We welcome the opportunity to work as an industry to ensure that disclosure is as clear as possible such that providers are properly accountable.

Q22: Do you agree that IGCs should be able to escalate concerns directly to the FCA, alert relevant scheme members and employers, and make their concerns public?

These powers are important but it is not clear that they are adequate. In particular, it is not clear what happens if the IGC feels certain members need to be moved out of a poorly performing investment vehicle, but the provider does not feel it has the legal power to alter the members' contracts without consent.

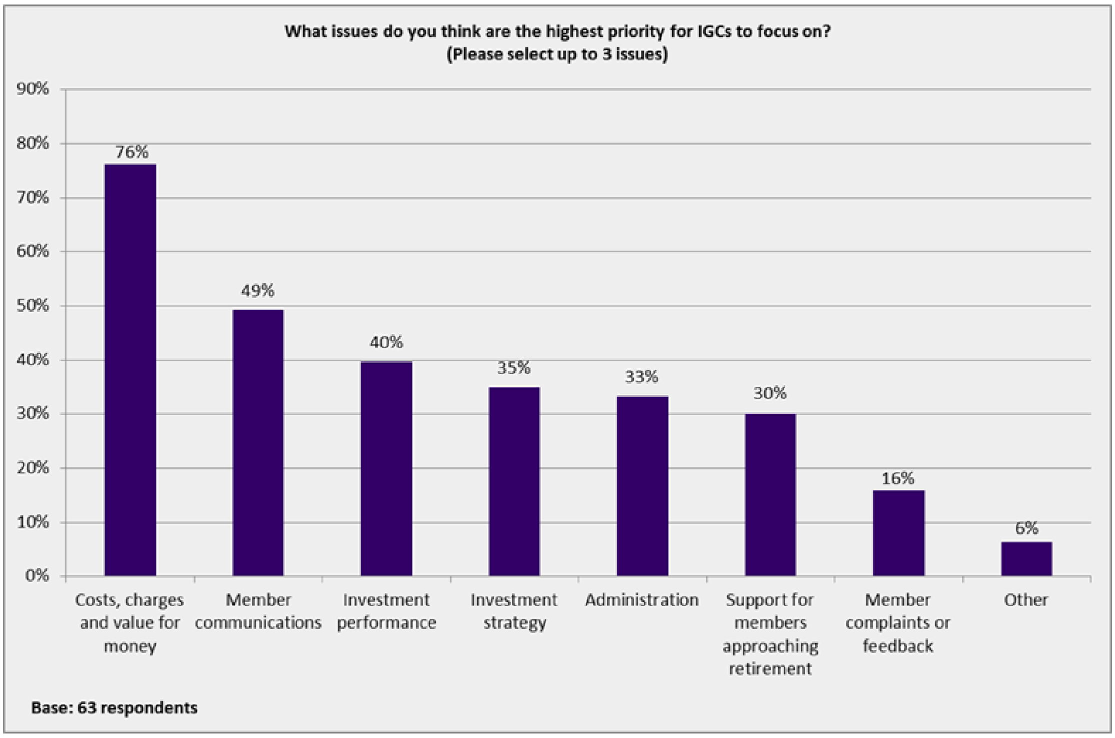
We hope the threat of contacting members will be enough to make providers take action as this is a blunt instrument that could cause members to worry, without helping them to remedy the situation, and also damage the reputation of pensions in general.

Q23: Do you agree that the IGC Chair should be required to produce an annual report and that the firm should be required to make this report publicly available?

Yes – reporting requirements should be broadly similar between IGC chairs and trustee chairs. For these reports to disclose costs in a meaningful way, the FCA and the industry need to make more progress in defining costs.

Q24: We would welcome views on where IGCs should focus their attention.

IGCs must be able to set their own priorities, but they should listen to the concerns of scheme members and employers in making those decisions. Our survey asked NAPF members and PQM holders what issues they thought were the most important for the new IGCs to focus on when they are set up. The top priority was 'costs, charges and value for money' with 76% picking this. The second priority was scheme member communications which was selected by half of respondents.



Q25: Do you agree that we should place a duty on the firm to provide the IGC with all information that it reasonably requests for the purposes of carrying out its duties?

Yes.

Q26: Do you agree that we should place a duty on the firm to provide sufficient resources to the IGC as are reasonably necessary for it to carry out its duties?

Yes. IGCs need to have their own budget so they can have control on how they use resources.

Q27: We would welcome views on possible arrangements to ensure that member views are directly represented to the IGC.

We agree that there should be no requirement for appointing or electing scheme members to IGC committees. This is impractical in many cases and there are often better ways of engaging with members and ensuring a wide range of members views are considered.

An easier way to get member engagement will be at an employer level. IGCs should be strongly encouraged to identify and make contact with all management or governance committees being run by employers using their provider and to set up a mechanism for listening to their views on the service being provided.

Q28: Do you agree that the firm should make the IGC's annual report and terms of reference publicly available?

Yes – transparency and accountability will be important for establishing IGCs' credibility and independence.

Q29: Do you agree that we should place a duty on the firm to address concerns raised by the IGC or explain to the IGC why it does not intend to do so?

Yes.

Q30: Do you agree that GAAs should be allowed as an alternative to IGCs for firms with smaller and less complex workplace personal pension schemes?

No. Good governance is important regardless of the size of the provider and needs to be resourced properly. Where providers do not believe they can resource governance costs then they should consider whether they want to continue to manage pension schemes.

Q31: Do you agree with our proposals for the type of firms that can use GAAs?

No. This seems to leave it to firms to decide whether or not they set up a full IGC or GAA without it being clear if the FCA can challenge the decision. It is not clear how FCA has come to the view that most members will be represented by IGCs not GAAs and what assumptions were used in that assessment.

Further information

For further information please contact:

Richard Wilson
Policy Lead: Defined Contribution Pensions
richard.wilson@napf.co.uk
020 7601 1724