Response from
the Independent Governance Committee ("IGC") of Phoenix Life Assurance Limited, Phoenix Life Limited and Standard Life Assurance Limited
to
FCA Consultation Paper 20/9
"Driving value for money in pensions"

Introductory comments

The IGC is grateful for the opportunity to respond to the FCA's consultation paper CP20/9. We welcome the FCA's desire to "make it easier for Independent Governance Committees (IGCs) to compare the value for money (VfM) of pension products and services, enabling them to be more effective in assess value for pension scheme members." Before presenting our responses to the questions posed in the CP, we would wish to highlight three points.

1. The risk of inadvertently limiting the influence of IGCs

As the FCA may recall from our response to CP19/15, we had been concerned that greater prescription on the assessment of VfM could inadvertently lead to restrictions on how IGCs have used the current flexibility around the meaning and measurement of VfM to drive up standards in the industry. For reference, the appropriate text from our response to CP19/5 is included in an appendix to this consultation response.

There is a danger that the proposed 3 element approach could have this unfortunate effect, and we suggest an approach for the proposed COBS wording that could mitigate this risk, and so benefit members of contract-based workplace pension schemes.

2. The interpretation of the word "scheme"

As the FCA may also recall, from our response to CP19/10, the IGC has been concerned for some time that the word "scheme" has a meaning in regulation that is inconsistent with how the term appears to be used in some FCA publications. One of the primary concerns that we set out in the introductory comments to our CP19/10 response was regarding the "Definition of scheme", where we said the following:

> ***Definition of scheme –*** *the proposals seem to be predicated on an assumption that each scheme has a unique set of charges and that all members of it fall within the remit of an IGC (or its equivalent). In practice, neither may be the case. Rather, more than one product type could sit within a single "relevant scheme" and, within a particular product type, the charges that apply to one employer's group pension arrangement could differ to those that apply to another. In addition, the product types within a particular "relevant scheme" could include individual business, which is not within the scope of the IGC. For example, across the two Phoenix life companies that we are concerned with* [i.e. within our scope]*, there are 46 personal pension and stakeholder pension schemes registered with HMRC, each having their own Pension Scheme Tax Reference (PSTR) and scheme rules originally approved by the Inland Revenue. Twenty of these schemes contain group personal pension or group stakeholder policies, as well as individual personal pension or stakeholder policies. (The other 26 schemes contain individual policies only, and so would not fall within the definition of "relevant scheme" for the purposes of COBS 19.5.) Within the 20 "relevant schemes" there are c. 790,000 members, but only c. 100,000 of these (i.e. less than 13%) are within the scope of the IGC.*

We remain concerned on this issue. It would seem to us that CP20/9 uses the term "scheme" to refer to an individual employer's workplace pension arrangement which is inconsistent with the level of disclosure that we are advised is required under PS20/02. As we set out below, in response to the relevant question, relevant scheme-level costs and charges information does not permit an employer-level comparison of such factors.

3. <u>The role of IGCs going forward</u>

We are very concerned about some of the potential implications of what CP20/9 is proposing. An employer by employer comparison of pension scheme VfM is impossible to carry out at this time. Sufficient information on charges and costs is not available at that level, and nor is sufficient information about quality of service. Even if it was, to carry out such an analysis at employer level would be a huge task – for example, we have in the region of 80,000 individual employer arrangements within our scope – and certainly not one that an independent group of non-executive "part-timers" could accomplish. A significant infrastructure would need to be built to accommodate the work demands, which feels entirely inconsistent with the non-executive governance and advisory role that IGC members had signed up to. Whilst the FCA is clearly within its rights to develop the role in this way if it believes that would be an appropriate and proportionate response to issues that it sees in the market, the corresponding CBA would need to include the impact and costs of the potential disruption to the membership of IGCs, as well as the significantly higher remuneration that such "executive" rather than "non-executive" roles would expect to command.

	Question	Response
1	Do you agree with our 3 proposed elements for assessing value for money? If not, what alternative factors do you suggest?	Not entirely. We agree that the 3 elements (level of costs and charges, investment performance and quality of service) are key elements of a VfM assessment and, as such, do not disagree with the proposal, at least to that extent. However, we are not convinced that it really adds much to the current frameworks in use by many IGCs. Indeed, it could be argued that the choice of just three elements rather downplays the significance of the quality of the proposition that is delivered to workplace pension customers – in particular, using the term "service" to cover the design of investment strategies, the provider's approach to ESG and other risk policies, the firm's culture and the lengths to which the provider goes to engage customers and encourage, where appropriate, more realistic levels of pension savings as well as what would normally be described as service (i.e. response times, available functionality, ease of use, clarity of communications etc.). To that end, it would be helpful if the new text in COBS that specifies these 3 elements could be phrased in a way that recognises that other elements are permitted to be taken into account in the assessment of VfM. We believe that other areas of VfM, that fall outside these 3 elements, should be allowed for if the IGC considers them appropriate – for example, other benefits members receive such as guarantees, a firm's risk management culture, the capital strength of the firm, and the firm's plans for improving any of these and other relevant elements over time. We believe it is important that the rules

		permit individual IGCs to tailor their assessments as they see fit, so long as those assessments cover at least the core elements that the FCA stipulates. The role that IGCs could play in increasing member engagement and promoting more active forward-looking retirement planning amongst in-scope customers should not be under-estimated, or inadvertently constrained by regulation. In terms of the wording proposed in COBS, we would highlight two other matters: 1. The new rules refer to "relevant scheme" which, as noted in our introductory comments, is not necessarily the same as an individual employer's workplace pension arrangement. Rather, the proposed wording for COBS is likely to cover a huge range of charge and quality of service combinations. Thus the comparisons that appear to be envisaged are impractical to carry out. 2. The proposed new rules also include terms which require subjective interpretation – e.g. "fit for purpose" and "properly take account of". It would be helpful if additional guidance were to be inserted in COBS to explain how the FCA intends that such terms should be interpreted. Without a clear definition of such subjective terms, there is a real danger that a firm and its IGC may end up at odds over their interpretation of the requirements. While an element of healthy tension is to be desired in such governance roles, there is a real danger that the use of such terms in a COBS Rule could lead to significant, inappropriate and unintended conflict that could work to customers' disadvantage.
2	**Do you agree with our proposed definition of VfM? If not, what alternative wording would you suggest?**	Not entirely. We agree that the proposed definition captures the key elements of a VfM assessment at a high level but, in line with our response to Q1, suggest that it is broadened to include reference to other potential elements of value (besides investment performance and services). We would also note that some of the wording used (e.g. "likely to" and "appropriate") may be open to a very wide range of interpretations. Is this the FCA's intention, or would it lead to more consistent outcomes if the words used were to have more precise definitions?
3	**Do you agree with our proposed process for VfM assessment? If not, what alternative process would you suggest?**	No. As already noted, as written, the proposed process will not operate as we believe the FCA envisages, since the text specifies the comparison at "relevant scheme" level (i.e. the vehicle registered with HMRC). We would have a major concern about the proposed process if the required comparisons are to be specified at the level of an

		individual employer arrangement. Within Phoenix Life, there are approximately 48,000 employer arrangements and, within Standard Life, approximately 32,000. Whilst, in Phoenix Life, many of the employer arrangements experience similar charging levels, within Standard Life bespoke charging arrangements are agreed with most employers on an individual basis. The charges are also in some cases informed by the fund(s) selected. As a result, the proposed process for VfM assessment (if specified at employer arrangement level) would need to be replicated thousands of times, which is entirely impractical. The likelihood is that the IGC would require to appoint external advisers to perform the benchmarking across thousands of arrangements. In principle, we do agree that external benchmarking is important – as is internal benchmarking with what the provider delivers for other workplace customers and at what price points. However, we propose that the requirement to conduct a comparative VfM assessment is left open for the IGC to: i. apply in a proportionate manner, taking into account the size and nature of the book(s); and ii. to set out in its report the approach and process undertaken. For example, many of the schemes operated by Standard Life are actively reviewed on a regular basis by the relevant employer and in conjunction with firms of employee benefit consultants, which provides some additional safeguard. This is in contrast to many Phoenix Life schemes which are 'legacy' in nature with a typically disengaged member and employer base (indeed the employer may not even be 'active'). As another example, in some instances employer arrangements within a particular contract design may be similar, in which case, sample testing may be more practical and appropriate than an employer-by-employer documented comparison.
4	**Do you agree with our proposals for IGCs to compare charges and transaction costs with other options on the market? If not, how should IGCs review costs and charges?**	No. We are concerned that any requirement for escalation by the IGC direct to individual employers is, or is bordering on, providing advice to employers, which the IGC is not best placed to provide. We also see little point in contacting the past employers of 'legacy' policyholders who now have no active relationship with any customers within the IGC's scope. As already noted, we do not believe that PS20/02 will provide suitable benchmarking data given that PS20/02 is based on disclosure of charges at a "relevant scheme" level (i.e. the vehicle registered with HMRC), such that the data disclosed will show a range or distribution of charges but will not describe the nature of the employer(s) (e.g. by size of membership, industry, contribution level, demographic base) that would permit a

		meaningful comparison. As described in our response to Q3, we feel that benchmarking is important but the process should be left open to individual IGCs to apply and describe in their reports.
5	**Do you agree with our proposed guidance that fully complying with the charge cap does not necessarily indicate value for money?**	Yes. We agree that compliance with a mandatory charge cap of 0.75% pa (or that charges within legacy schemes being within 1% pa) does not necessarily imply VfM.
6	**Do you agree that a reasonable comparison of costs and charges with other options available on the market will put pressure on high-charging providers to reduce their charges and transaction costs? If not, how else could this outcome be achieved?**	Yes – but it must be "reasonable". We agree that further transparency and benchmarking of costs and charges will increase the spotlight on higher charging providers. However, such comparison must be appropriate, proportionate, available and usable. We do not believe that the current proposals, set in the context of the publication required by PS20/02, satisfies these attributes.
7	**Do you think that further guidance will improve the assessment of legacy products?**	Possibly. As an IGC, we apply the same VfM framework to 'legacy' business as we do to currently-marketed products. We don't see that, just because a customer started their pension pot perhaps many, many years ago, they should not benefit from features of more modern products (e.g. online functionality; digital guidance material; improved communications) and the benefits of scale where appropriate. One of the challenges that has faced an industry group (of which we are part) in developing a benchmarking exercise for 'legacy' business is to determine a definition of "legacy". If the FCA has its own view of what should constitute "legacy products" and how a legacy VfM assessment might differ from that of actively marketed products, then it would be helpful for us to know that.
8	**Do you think that our proposed rules and guidance will improve the clarity of IGC annual reports?**	No – indeed, quite the reverse. The IGC is concerned that the proposals will result in annual reports that few customers will end up reading. Phrases like "in sufficient detail" and "fully and properly" suggest to us a level of explanation and a length of document that is not consistent with

		the level of engagement of most workplace pension customers. It is also not clear to us how the FCA's support for a "two report" approach (as set out in PS19/30, in response to the answers received to Q4 in CP19/15) fits with the proposed requirements. Does the FCA envisage a return to a single report, aimed at customers, but which contains the "sufficient detail" and evidence of full and proper analysis that the FCA is seeking? If not, to which report do the proposed new requirements apply? Also, does the FCA still have the desire, first stated when IGCs were being set up, that the annual reports should be of interest to other stakeholders and enable external scrutiny of the work of each IGC? It is not clear to us how these differing needs and perspectives fit with what is proposed in the CP. If the FCA does wish to maintain these desired outcomes from IGC reporting, it would be helpful if this were to be set out in COBS, perhaps along the lines of: • a member summary that highlights the key conclusions and things a member should consider (which, at least initially, the vast majority may not read but, at least it would be designed for them, and could be used to help increase member engagement); and • a more detailed report with the detail that industry experts, EBCs, commentators, regulators and other stakeholders might read (and maybe a handful of members) and which evidences the IGC's basis of assessment and how the key conclusions were reached.
9	**Do you think that firms providing pension products should have a specific responsibility on ensuring the VfM to customers of these products?**	Not necessarily. Placing a specific responsibility on providers to ensure VfM for these products would not be expected to *worsen* the value a member receives. However, to what extent it would *improve* customer outcomes is not clear to us, given the role that we already perform and the publication obligations already associated with that. If anything needs to be added to regulatory obligations in this area, it should be to encourage providers (and perhaps IGCs – see our comments in response to Question 1 above) to put even more focus on improving customer engagement – not just with their current pension savings, but also with their retirement planning. The retirement outcomes that workplace pension customers will experience are likely to depend at least as much, if not more so, on what they choose to save as on what improvements to VfM are delivered by the provider going forward. On the other hand, the narrower responsibility proposed in the CP could actually significantly change the nature of the relationship between the IGC and the provider since it could turn discussions around VfM and how customer outcomes might be

		improved over time into discussions around regulatory compliance with SMF responsibilities. Turning constructive challenge into arguments around whether or not regulations have been breached may stifle IGCs and so not prove of long-term benefit to customer outcomes.
10	**Do you agree with the analysis set out in our cost benefit analysis?**	Not all of it. Given the concerns we have expressed above about the practicality and appropriateness of what is proposed in the CP, we have not considered it appropriate to offer corresponding revisions to the CBA.

D J P Hare, IGC Chair

on behalf of the IGC for Phoenix Life Assurance Limited, Phoenix Life Limited and Standard Life Assurance Limited

24 September 2020

Appendix – relevant extracts from previous consultation responses from the IGC

Response to Q9 in CP19/15:

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 note that the intention for “the further development of common principles and standards for value for money and the enforcement of those standards” was identified as one of the priorities for joint action within the joint Pensions regulatory strategy published by you and tPR in October 2018.

If, as the conduct regulator of the firms that appoint IGCs, the FCA has particular views on specific aspects of value for money assessment then, of course, it is helpful for those to be made public.

However, one of the advantages of the current wording in COBS 19.5 (in not defining value for money in great detail, but just listing the minimum aspects that should be considered) is that IGCs are then free to extend the scope of their VfM assessment as widely as they think appropriate. When this freedom is set in the context of public reporting by IGCs, then the foundation is laid for a levelling up of standards and review across the industry – as can be seen from the way IGCs would appear to have learned from each other and shared best practice since they were set up in 2015. We believe this has been an important aspect of how the FCA went about the introduction of IGC oversight and has played an important role in achieving the resulting customer benefit.

It would be a great pity if greater prescription on the assessment of value for money were inadvertently to lead to restrictions on this continuing in future.”