Response from
the Independent Governance Committee (“IGC”) of Phoenix Life Limited, Phoenix Life Assurance Limited and Standard Life Assurance Limited
to
FCA Consultation Paper 19/15
“Independent Governance Committees: extension of remit”

Introductory comments

The FCA has set out proposals to help make sure that consumers with investment pathway solutions get good value for money. In particular, you have proposed that providers of drawdown solutions must offer non-advised consumers entering drawdown a choice between 4 clear and prescribed objectives for what they want to do with their drawdown savings. In this consultation paper, you propose rules and guidance that will require IGCs to assess the value for money of pathway solutions. You also propose rules and guidance to extend the remit of IGCs to oversight of ESG and other investment-related matters, following on from the Law Commission’s 2017 proposals.

In the main, we welcome these proposals. However, we are very concerned that the proposed wording in COBS regarding the IGC oversight of investment matters might inadvertently create much wider obligations on IGCs than we understand is the intention. Set out below, after some initial comments on investment pathways, are our responses to the specific questions set out in the consultation, including an explanation of this reservation.

The uptake by consumers of the investment pathways will to a large extent be determined by the design of the customer journeys within which the pathways sit. Current customer behaviour, particularly within the Workplace market, suggests that many customers continue to deploy the investment solution designed for the accumulation phase of their savings journey upon first accessing their pension. On the assumption that the investment pathways will become more widely utilised by customers, then we agree that oversight of the value for money provided to consumers is a role that could be undertaken by IGCs given their experience to date.

There are, however, a number of general observations that we’d like to highlight as part of our submission. These reflect our observations of consumer behaviour and the market response since the pension freedoms were introduced in April 2015, and indeed reflect the FCA’s own findings in your Retirement Outcomes Review published in July 2017. We also highlight some potential consequences arising from the introduction of investment pathways which are offered to customers of some DC pension arrangements but not others. In particular, we note the following:

a) The majority of customers who are “accessing” their pension plans are doing so to access a cash lump sum – typically the 25% tax-free element of their plan. (In 2018, 88% of Standard Life Assurance Limited’s non-advised drawdown customers accessed either their tax-free cash only or tax-free cash plus a taxable lump sum. Furthermore, 59% of those first accessing their pension savings were aged 60 or under). In doing so, we agree with the findings in the Retirement Outcomes Review, that many customers do not view this as a “retirement” event.
Relevance: Introducing extra steps to the customer journey (through the introduction of investment pathways) may be considered by some customers in this situation as a barrier to access.

b) Among those providers offering access to the pension freedoms within a Workplace arrangement, the experience of members is generally to leave the remainder of their

pension savings in their existing investment solution (which is typically the scheme "default" investment strategy). According to research undertaken in April 2019 by Redington, 8 out of 10 providers offering "in-scheme" drawdown do not require members to make an active investment choice. This reflects the general lack of engagement among members on the nature of the investments upon which they are relying when saving for their retirement.
Relevance: Requiring customers wishing just to access tax-free cash to engage in an investment decision regarding the rest of their pension pot when they have failed to do so during the period of building up their pension savings may be considered by some customers as a barrier to access.

c) In the FCA's Retirement Outcomes Review, you found that 33% of non-advised drawdown customers were being defaulted into cash or cash-like assets. Many pension providers, including Standard Life Assurance Limited, have since updated their investment "default" solutions to reflect the behaviour of customers; most now lifestyle the customer towards their selected "retirement" date with a target asset allocation which is a well-diversified range of assets with relatively low levels of investment risk. Our understanding is that it is increasingly rare for pension savers to be in a solution which either targets the purchase of an annuity or results in a significant holding in "cash".
Relevance: The introduction of investment pathways may result in members incurring additional transaction costs arising from a switch from their current investment solution to one of the four investment pathway solutions.

d) The provision of drawdown solutions "in-scheme" (i.e. allowing members of Workplace schemes to access the pension freedoms without the need to transfer to another provider / product) is a core feature of the growing market for "Master Trust" propositions – an area where neither the FCA nor IGCs have any regulatory oversight.
Relevance: There is a risk of regulatory arbitrage and/or a reduction in the number of consumers who might otherwise "shop around" for a drawdown vehicle which may lead to consumer detriment over the medium term.

e) Members who access their pension savings via an "Uncrystallised Fund Pension Lump Sum" (UFPLS) often experience poorer outcomes than those who do so via "Flexi-Access Drawdown" (FAD) - in terms of tax treatment and the ability to continue to save in a pension plan thereafter (i.e. because of the reduction in the Money Purchase Annual Allowance from £40k to £4k). By way of illustration, consider the following example (based on our understanding of the current tax rules) of two customers, A and B, each aged 55 and both with pots of £100k. Both require a one-off lump sum of £20k (net of tax) from their plan. Both are 20% taxpayers.

- Customer A is a member of a scheme that offers access via FAD. As a consequence, the customer has the option to take £20k as part of their tax-free lump sum entitlement. However, under the proposals in the CP, the customer will then have to take an investment decision and inform the scheme/provider of which investment pathway they wish the remaining £80k to be invested in.

- Customer B, on the other hand, is a member of a scheme that only offers access via UFPLS. To receive their £20k, the customer needs to disinvest £23.53k and pay tax of £3.53k (i.e. 20% of 75% of the amount disinvested). However, they would not be impacted by the CP pathway proposals and so would not be required to make any investment decisions around the remaining £76.47k pot or make any changes to the current strategy.

Both customers have essentially the same immediate need, but customer B will end up with a smaller pension pot and hence may experience a different (and potentially worse) set of outcomes in retirement.

Relevance: The FCA's proposal to limit the introduction of investment pathways to FAD only, may artificially distort the design of future drawdown solutions (e.g. by inadvertently discouraging the availability of FAD) and lead to poorer retirement outcomes over the medium term.

	Question	Response
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 agree that "IGCs stand in the place of [in-scope] consumers and provide expert and informed challenge to providers to improve their products" and that it makes sense to extend their obligations to cover these important matters, as they impact the investment of in-scope policyholders' units. However, our reading of the proposed new rules in COBS goes much further than this, and would appear to require IGCs to review all investment activity of their provider, including the investment of shareholder funds and those assets backing non-profit contracts, and not just the investments backing in-scope unit-linked policies. It may be that the solution is as simple as inserting the word "relevant" before "investment strategies" and "investment decision making" in the proposed 19.5.5R (2B) (a) and (b). We would also highlight that the financial considerations listed in the proposed new SYSC text are capable of very wide application. It may be helpful for the final Handbook Text to make clear that the IGC obligations in COBS19.5.5R (2B) concerning these financial considerations are focussed on their impact on the suitability of the resulting strategies for the investment of in-scope workplace pension pots and not on a wider review of the provider's policies for managing each of these risks/issues.
2	**Do you agree that IGCs should report on how the firm has implemented its policies on ESG issues, member concerns and stewardship?**	We agree with the statement in 2.31 that "IGCs promote greater transparency and thereby allow employers, consumer representatives and interested members of pension schemes to engage better with providers." We therefore agree that it makes sense for the IGC not just to report on the policies in place to cover these important matters, but also to report on the IGC's views regarding how the firm has implemented them. We would, however, flag that the proposed new COBS rule regarding this is silent on how detailed the FCA expect the review of implementation by the IGC to be. While we would expect each IGC to be capable of exercising appropriate judgement in this regard, if the FCA have strong views on how rigorous the review should be (e.g. should it be based on independent assessment or just evidence from within the firm), it would be helpful for this to be made clear.

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 agree that any IGC oversight of a provider's policies on ESG and related matters should also cover investment pathway solutions for customers accessing their pension savings. (We would note that as more providers offer access to the pension freedoms as an "integrated" element of a workplace personal pension, there should naturally be a consistency of approach to ESG etc.)
4	**Do you agree that firms should make the IGC's annual report publicly and prominently available, with 2 prior year reports for comparison?**	Yes.
5	**Do you agree that the proposed guidance should apply more widely, to all firms that provide pension products and all life insurers that provide investment-based life insurance products?**	While these other products are not within our scope as an IGC, we can see advantages in having a consistent approach across the various types of long-term accumulation products that are available to consumers from such firms. It may be that, in this context, the wider application resulting from the definitions of "investment strategies" and "investment decisions" that we have queried in relation to IGCs, is not such an issue.
6	**Do you agree that we should focus our requirement for an IGC on firms offering pathway solutions to consumers?**	We agree that firms offering pathway solutions (either manufactured in-house or sourced from a third party) directly to consumers should be required to have an IGC. Where a firm (firm A) does not offer pathway solutions directly to consumers but, say, manufactures them for another firm (firm B) to offer directly, then we agree that it is firm B that should be required to have an IGC and not firm A.
7	**Do you agree with our proposed approach for providers with smaller numbers of non-advised consumers entering drawdown?**	We have no opinion on the FCA's proposed governance arrangements for firms with fewer than 500 non-advised drawdown customers.
8	**Do you agree that IGCs must be in**	We note the logic of IGCs being in place to assess the value for money of pathway solutions prior to these being offered to

	place in time to assess the initial designs of pathway solutions?	consumers. While we agree with this proposed requirement, we note that a growing number of providers are offering their customers access to their pension through a Workplace Master Trust arrangement which may already be utilising investment pathways, i.e. before IGCs have had an opportunity to undertake a value for money assessment.
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 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.
10	**We welcome your view on what legacy pension products should be compared with, when assessing value for money.**	We remain of the view that we have set out in previous reports, that value for money in a particular situation needs to be considered in the context of what is available in the market for similar situations. For example, while small pension pots within a large employer group pension arrangement may well benefit from resulting economies of scale and employer purchasing power, such terms may not be available on such small pension pots if they were "stand alone". Thus, when assessing the value for money of, say, a relatively small paid-up pension pot, it is the terms available in the market for an individual single premium policy of that size which is more important – although, as noted above, the current requirements of COBS 19.5 leave the IGC open to pushing for better terms and/or other improvements to the customer outcome.

11	**Do you agree with the conclusion and analysis set out in our cost benefit analysis?**	While we cannot comment on all the detail in the analysis, it did not look unreasonable to us. It also seemed to reflect the input on current costs that we had shared with the FCA as you were preparing the CP.

D J P Hare, IGC Chair, on behalf of the IGC for Phoenix Life Limited, Phoenix Life Assurance Limited and Standard Life Assurance Limited

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