Independent Governance Committees: extension of remit

Consultation Paper

CP19/15***

April 2019

How to respond

We are asking for comments on this Consultation Paper (CP) by **15 July 2019**.

You can send them to us using the form on our website at: www.fca.org.uk/cp19-15-response-form

Or in writing to:
John Reynolds
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Email:
cp19-15@fca.org.uk

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1 Summary

Why we are consulting

1.1 Independent Governance Committees (IGCs) currently oversee the value for money of workplace personal pensions provided by firms like life insurers and some self-invested personal pension (SIPP) operators. IGCs provide independent oversight of workplace personal pensions in accumulation i.e. before pension savings are accessed. They act on behalf of consumers who are likely to be disengaged or less engaged with their pension savings.

1.2 We are consulting on rules to extend the remit of IGCs in 2 areas:

- a new duty for IGCs to report on their firm's policies on environmental, social and governance (ESG) issues, consumer concerns and stewardship, for the products that IGCs oversee
- a new duty for IGCs to oversee the value for money of investment pathway solutions for pension drawdown

1.3 In the first area, our proposals are to help protect consumers from investments that may be unsuitable because of ESG risks including climate change, to help make sure that consumer concerns are taken into account, and to help encourage good stewardship of investments. (Paragraph 2.19 explains what we mean by stewardship.) We also propose related guidance for providers of pension products and providers of investment-based life insurance products. This proposed guidance sets out how these firms should have regard to factors that can have an impact on financial returns, such as ESG risks and opportunities, and to non-financial consumer concerns, when making investment decisions on behalf of consumers.

1.4 Our proposals in this area address recommendations made by the Law Commission, in its June 2017 report on Pension Funds and Social Investment. In some respects our proposals go further.

1.5 In the second area, our proposals are to help make sure that consumers with investment pathway solutions get good value for money. In our January 2019 Retirement Outcomes Review consultation paper (CP19/5), we proposed changes to our rules and guidance to require drawdown providers to offer investment pathways to non-advised consumers entering drawdown. We proposed that providers 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. For each of these objectives, larger drawdown providers must offer a single investment solution (a 'pathway solution')[1].

1.6 In CP19/5, we said that we intended to extend the remit of IGCs to investment pathways. In this consultation paper, we propose rules and guidance that will require IGCs to assess the value for money of pathway solutions.

1 'Pathway solution' has the same meaning as the defined term 'pathway investment' in our proposed rules

1.7 In this consultation paper, we also discuss what we have seen in published IGC annual reports and from our engagement with IGCs. Separately, we invite views on issues relevant to our planned work with the Pensions Regulator (TPR) on value for money in pensions. (Chapter 5)

Who this applies to

1.8 This CP will mainly be of interest to:

- firms that intend to provide pathway solutions and that provide workplace personal pensions
- IGCs and Governance Advisory Arrangements (GAAs)[2]
- third party firms that provide GAAs or are considering whether to provide GAAs
- consumer representative groups with an interest in ESG issues and pensions
- all firms that provide pension products and all life insurers that provide investment-based life insurance products

1.9 This CP will also be relevant to stakeholders with an interest in pensions and retirement issues, including:

- individuals and firms providing advice and information in this area
- distributors of financial products, in particular, retirement income products
- trade bodies representing financial services firms
- charities and other organisations with a particular interest in the ageing population and financial services

1.10 Consumers will also be affected by this CP. We welcome views from consumers on all our proposals.

Outcomes we are seeking

1.11 Our overall objective is to help make sure that the pensions sector delivers good outcomes for consumers with workplace personal pensions and, in the future, pathway solutions. We want to help make sure that these consumers do not lose money as a result of unsuitable investments, for example due to ESG risks including climate change. We also want investment outcomes that appropriately reflect consumer concerns, while not exposing them to significant financial risk. And we want these consumers to benefit from good stewardship of their investments, to create sustainable value as well as benefiting the economy and society.

1.12 We also want to help make sure that pathway solutions offer good value for money. That means costs and charges that are good value relative to the quality of the pathway solution and associated services, and a pathway solution that is appropriate for the consumers invested in it.

2 GAAs are a proportionate alternative to IGCs for firms with smaller numbers of relevant customers and less complex relevant products

Measuring success

1.13 In the first area of our proposals, we will not know the impact on pension outcomes for many years, if at all. But we can see the extent to which providers and IGCs are engaging on ESG issues, consumer concerns, and stewardship. We expect IGCs to include in their published annual reports their opinion on the adequacy and quality of the firm's policies on these issues in relation to the products that IGCs oversee, any concerns that IGCs have raised, and how providers have responded.

1.14 In the second area, we expect to see IGCs raising any concerns they may have about the value for money of pathway solutions, and providers addressing these concerns. We will begin a review of the impact of the wider investment pathway proposals in CP19/5, 1 year after their implementation. This review will look at different aspects of the policy framework, including analysis of the charges providers are applying to pathway solutions. The review will help us evaluate the success of IGCs in helping to make sure that pathway solutions are good value for money.

Next steps

What you need to do

1.15 We want to know what you think of our proposals and invite your responses to the questions in this paper, which are also included in Annex 1. Please send us your comments by 15 July 2019.

How to respond to this consultation

1.16 Use the online response form on our website, email us at CP19-XX@fca.org.uk or write to us at the address on page 2.

What we'll do next

1.17 We will consider the feedback we receive on this CP and publish our finalised Handbook text in a Policy Statement in Q4 2019.

2 The wider context

Background to IGCs

2.1 Automatic enrolment profoundly changed the dynamics of the workplace pensions market by simultaneously increasing the number of enrolled individuals, employers offering schemes and the value of assets in workplace schemes. In anticipation of these changes, in 2013 the Office of Fair Trading (OFT) conducted a study into the market for defined contribution (DC) workplace pensions, to examine whether competition was likely to drive value for money and good outcomes for scheme members.

2.2 The OFT found that the demand side of the market was 'one of the weakest' it had analysed which, combined with charging complexity, reduced competition on charges. The OFT also found that competition alone could not be relied upon to drive value for money for all savers in the DC workplace pension market.

2.3 In response, the FCA, the Department for Work and Pensions (DWP) and TPR worked closely to design a package of measures to address the risks of consumer harm that were present at the time and prevent risks of consumer harm in the future.

2.4 As a key part of this package, in 2015 we introduced rules to require providers of workplace personal pension schemes to establish IGCs to provide independent oversight of the value for money of these schemes. IGCs have a similar role to the trustees of occupational pension schemes and must act independently and solely on behalf of scheme members in assessing value for money.

2.5 Under our rules, IGCs have the power to raise any concerns they may have directly with the governing bodies of providers (typically the Board) and providers must respond to these concerns. An IGC may escalate its concerns to the FCA, where the IGC considers that the firm has not satisfactorily addressed its concerns, and may alert relevant scheme members and employers and make its concerns public.

2.6 IGCs are not intended to undermine or weaken the obligation on providers to treat their customers fairly. But where competition is weak, as in the market for workplace personal pensions, they can help ensure good value for money.

2.7 IGCs must already produce an annual report that includes their opinion on the value for money of the provider's workplace personal pensions and how the IGC has considered the interests of scheme members.

Wider FCA Work

Sustainable finance and climate change

2.8 We are involved in several sustainable finance[3] initiatives underway at EU and UK level. These initiatives have the potential to improve market integrity, promote competition, and better protect consumers investing in sustainable activities, as well as helping to protect our shared future environment.

2.9 The EU is developing a package of sustainable finance initiatives and policies, known as the Sustainable Finance Action Plan. This work includes important proposals for advice and disclosure:

- requiring consideration of sustainability risks as part of the duties of institutional investors and asset managers
- requiring asset managers, financial advisors, insurance companies and pension funds to disclose how they integrate ESG factors in their investment decision-making and advisory processes
- the introduction of two new categories of climate-related benchmarks, which include a carbon footprint benchmark, so that the performance of investments can be tracked against these
- the creation of an EU classification system ('taxonomy') on what can be considered sustainable activities, towards a common language for all stakeholders

2.10 In October 2018, we published a Discussion Paper on Climate Change and Green Finance. We asked for views on where we should focus our efforts, including on climate-related disclosure requirements, reporting requirements, taxonomy, standards and common metrics, innovation in green finance, and industry engagement. We were encouraged by the broad range of stakeholders responding to our questions and plan to publish a feedback statement in due course.

2.11 We have established a new FCA-Prudential Regulation Authority (PRA) Climate Financial Risk Forum to look at climate-related financial risks, share best practice and provide intellectual leadership in this emerging field. We also seek to encourage green finance innovation. In October 2018, we launched our Green FinTech Challenge, which will provide support to a selection of firms developing innovative products and services to assist in the UK's transition to a greener economy.

Other relevant pensions work

Review of IGC effectiveness

2.12 We plan to review IGC effectiveness in 2019/20.

Transaction cost disclosure

2.13 Since January 2018, our rules have required asset managers to report transaction costs and other charges to the operator, trustee or manager of workplace pension schemes. In February 2019, we published a consultation paper on new rules to require scheme governance bodies, like IGCs, to disclose transaction costs and administration charges onwards to members on an ongoing basis.

3 Sustainable finance refers to the financing of activities that take into account ESG considerations

Non-workplace pensions

2.14 We have diagnostic work underway on whether competition is working well in the market for non-workplace pensions. We seek to understand whether providers are competing on charges, and if there are barriers to consumers identifying and choosing from more competitive products.

2.15 We recognise that there are many distinguishing features between the markets for non-workplace and workplace pensions. We will take these differences into account when assessing the potential for consumer harm in non-workplace pensions.

2.16 We plan to publish a paper later in 2019 which will provide feedback on the themes in our diagnostic work. If the evidence demonstrates the existence of consumer harm, we will subsequently consult on proposals to remedy this.

Value for Money (VFM)

2.17 In October 2018, we published our Joint Pensions Strategy with TPR, in which we set out our longer-term objectives for the pensions and retirement income sector, and the initiatives we will pursue to achieve these. We identified the risk that pension savings are not always well looked after by providers and trustees. In our Joint Pensions Strategy, we set out workstreams to address it, including work with TPR on developing common principles and standards for the assessment of value for money. This work may result in more prescriptive rules and guidance for firms and IGCs on how they should assess value for money.

Stewardship work

2.18 In January 2019, we published a consultation paper (CP19/7) on measures to implement the provisions of the amended Shareholder Rights Directive (SRD II) for FCA-regulated life insurers and asset managers. From June 2019, asset managers and life insurers must disclose their engagement policy or explain why they don't have one. At the same time, we published a joint discussion paper (DP19/1) with the Financial Reporting Council (FRC) on the importance of effective stewardship, and the FRC published a consultation on proposed revisions to its Stewardship Code.

2.19 In DP19/1, we defined stewardship as the responsible allocation and management of capital across the institutional investment community, to create sustainable value for beneficiaries, the economy and society. Stewardship activities include monitoring and engaging with issuers of shares and bonds, holding them to account on material issues, and publicly reporting on the outcomes of these activities. This definition is also the definition in the Financial Reporting Council's revised Stewardship Code.

Wider governance work

Senior Managers and Certification Regime (SM&CR)

2.20 The SM&CR came into force for banking firms in March 2016 and was extended to insurers in December 2018. It will be extended to all FCA solo-regulated firms from 9 December 2019. The aim of the SM&CR is to reduce harm to consumers and strengthen market integrity by making individuals more accountable for their conduct and competence.

2.21 We have considered the role of independent governance in the context of the SM&CR. Independent governance is not intended to undermine or lessen the individual responsibilities of firm employees. It can provide a check and challenge where markets are not working well and consumer outcomes are at risk.

2.22 In the market for workplace personal pensions, IGCs provide this independent check and challenge on value for money issues. An assessment of whether or not there are concerns about the value for money offered by a product is to some extent subjective. In the workplace personal pensions market, providers may not always have strong commercial incentives to deliver good value for money.

Authorised funds

2.23 Following our Asset Management Market Study (AMMS), we introduced new measures to improve the governance of authorised funds. From 30 September 2019, fund managers must assess annually whether the charges taken from a fund are justified in the context of the overall value provided by the fund (an 'assessment of value'). A senior manager must be individually responsible for making sure that this is done. AFM boards must include a minimum of 25% independent directors, to introduce a check and challenge in the Board decision-making process, including on the assessment of value.

Unit-linked and with-profit funds

2.24 Our asset management remedies are focused on authorised funds. In our consultations on these remedies, we also discussed whether we should extend our proposals for authorised funds to unit-linked and with-profits funds. We have since undertaken diagnostic work on unit-linked and (separately) with-profits funds.

2.25 Our diagnostic work on unit-linked funds found that firms often do not demonstrate sufficiently effective fund governance to consider the value provided by unit-linked funds. We will think about possible remedies after our diagnostic work on non-workplace pensions has been completed, since non-workplace pension products often use unit-linked funds, and charging structures are set at a product level.

2.26 We have no evidence to suggest the need for immediate action to strengthen rules or guidance for the governance of with-profit funds.

What we are doing

2.27 We are consulting on rules to extend the IGC regime in 2 areas:

- a new duty for IGCs to report on their firm's policies on ESG issues, member concerns and stewardship, for the products that IGCs oversee (Chapter 3)
- a new duty for IGCs to oversee the value for money of pathway solutions for pension drawdown (Chapter 4)

2.28 We also discuss what we have seen in published IGC annual reports, and from our engagement with IGCs. We invite views on what we might consider in further work on value for money in pensions. (Chapter 5)

How this links to our objectives

Consumer protection

We aim to protect disengaged or less engaged consumers using these products

2.29 Consumers with workplace personal pensions and pathway solutions are likely to be disengaged or less engaged with their pension or drawdown savings. The complexity of pension products, both their costs and quality, make decision making difficult for many consumers. Consumers may tend to leave investment decisions to their pension provider and not question the cost or quality of the product. In workplace personal pensions, consumers are reliant on their employers to choose and stay engaged with a pension provider. Employers may also lack the capability and incentive to make sure that their employees and past employees receive value for money in the long term.

2.30 Our proposals to extend the IGC regime are designed to address the risk that, against this backdrop, providers may not always deliver good pension outcomes for consumers. IGCs stand in the place of consumers and provide expert and informed challenge to providers to improve their products.

Competition

We seek to encourage competition between providers when consumer pressure is lacking

2.31 IGCs promote greater transparency and thereby allow employers, consumer representatives and interested members of pension schemes to engage better with providers. This may increase competition between providers to design and monitor investment strategies that incorporate ESG factors and protect consumers from potentially unsuitable investments. It may also increase competition between providers to design and maintain good value for money pathway solutions.

Equality and diversity considerations

2.32 We have considered the equality and diversity issues that may arise from our proposals.

2.33 Overall, we do not think that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. We expect our proposals to have a positive impact on older consumers using pathway solutions. We will continue to consider the equality and diversity implications of the proposals in the light of the feedback we receive during the consultation period, and will revisit them when publishing the final rules.

3 ESG issues: IGC oversight of firms' policies

3.1 In this chapter, we propose extending the remit of IGCs and GAAs[4] to provide independent oversight of their firm's policies on ESG risks including climate change, member concerns and stewardship, for the products that IGCs oversee.

Why are these issues important to pension outcomes?

3.2 Consideration of ESG risks is not about firms being altruistic, but about how long-term risks are factored into investment decision-making. For example, climate change and the transition to a low carbon economy is a risk – and an opportunity – that providers should think about.[5] This is important for pension products, which by their nature are for the long term.

3.3 Many larger pension providers already have ESG policies and already take member concerns into account, for example through the provision of fund options that members can choose for their pension savings. Many larger pension providers also have stewardship policies. However, a pension provider must take the initiative and act on behalf of consumers on these issues, when there is not always a strong commercial reason to do so.

3.4 We want to encourage the providers of these products to think how they can do more to protect consumers from risks, take advantage of opportunities, and improve pension outcomes. We believe that IGC oversight of providers' policies on ESG issues, consumer concerns and stewardship, and of what the provider does in practice, can provide a check and challenge where it is needed.

The Law Commission's recommendations

3.5 In June 2017, the Law Commission published its final report on Pension Funds and Social Investment. The aim of the Law Commission's work was to clarify how far workplace pension schemes should think about issues of social impact when making investment decisions.

3.6 The Law Commission concluded that the barriers to pension funds investing for social impact were mainly structural and behavioural rather than legal or regulatory. However, to reduce the impact of these barriers, the Law Commission recommended changes to the rules for workplace personal pension schemes (for us to take forward) and similar changes to the regulations for occupational pension schemes (for the DWP to take forward).

3.7 The Law Commission recommended that we make rules requiring IGCs to report on firms' policies on how they take account of ESG risks and member concerns in investment decision making. Member concerns might be non-financial, like an ethical position on the inclusion of certain types of investment in their pension scheme's investment strategy. The Law

4 In this consultation paper, where we say IGCs we mean Governance Advisory Arrangements (GAAs) as well, unless we state otherwise. We explain GAAs in paragraphs 4.41 – 4.43 of the next chapter.

5 For example, the risk to the value of assets both as a result of climate change and as a result of action to combat climate change

Commission also recommended that we make a rule requiring IGCs to report on firms' stewardship policies, if the firm has a policy.

3.8 The Law Commission recommended that we issue related guidance for firms to clarify how they should take account of ESG risks and member concerns in investment decision-making for pensions. The Law Commission proposed guidance setting out that:

- firms should take account of all financially material risks, including financially material ESG risks
- firms may take account of non-financial concerns, but only where members generally share the concern and where this doesn't risk significant financial detriment to members

3.9 The Law Commission made similar recommendations to the DWP that trustees of occupational pension schemes should be required to report on their policies about ESG issues, member concerns and stewardship.

Our response to the Law Commission's recommendations

3.10 In June 2018, we published our final response to the Law Commission's proposals, as part of a combined government and FCA final response. We said that we broadly agreed with the Law Commission's recommendations. We considered that these proposed measures would enhance consumer protection by requiring IGCs to engage with providers on these issues.

3.11 In September 2018, the DWP published amendments to the Occupational Pension Schemes (Investment) Regulations 2005 to address the Law Commission's recommendations for trustees. We have worked closely with the DWP and have sought to align our proposed measures with the DWP's amendments.

The providers covered by these proposals

3.12 Our proposals cover the providers of workplace personal pensions and pathway solutions. Our proposed guidance on long-term investment decision making applies to all firms that provide pension products and all life insurers that provide investment-based life insurance products.

Proposed new rules and guidance

3.13 We propose new rules and guidance to take forward the Law Commission's proposals and go further in some areas:

- We propose to clarify that, in reporting on the policies of firms about ESG issues, member concerns and stewardship, IGCs should consider the adequacy and quality of these policies, and should raise with the firm any concerns they may have.
- We propose to require that IGCs also report on how the firm has implemented its policies on these issues, to help make sure that firms follow their stated policies.
- We propose to require that IGCs report on the firm's policies and their implementation for pathway solutions (see section below) as well as workplace personal pensions.
- We propose wider application of the related guidance for firms, to all firms that provide pension products and all life insurers that provide investment-based life insurance products, rather than to the providers of workplace personal pensions only.

3.14 We discuss each of these areas in more detail below.

Requiring IGCs to report on the firm's policies on ESG issues, member concerns and stewardship

3.15 Firms making long-term investment decisions on behalf of consumers should think about ESG risks including climate change. But we do not want firms to focus on ESG issues to the exclusion of other financially material risks, like interest rate, inflation, liquidity, concentration, exchange rate, political and counterparty risks. So, in line with the DWP, we propose to require IGCs to report on the firm's policies on financially material issues, including ESG and climate change issues. This includes opportunities as well as risks.

3.16 We also propose to require IGCs to report on the firm's policy on how much (if at all) the ethical and other concerns of consumers are taken into account in investment strategies and investment decision making. Non-financial consumer concerns can be taken into account. But we agree with the Law Commission that scheme members (or customers) should generally share the concern, and addressing the concern should not risk significant financial harm to members.

3.17 We also propose to require IGCs to report on the firm's stewardship policy. We have already consulted on measures to implement the provisions of the amended Shareholder Rights Directive (SRD II), which would require life insurers to have a policy (on a comply or explain basis) about their engagement strategies and to disclose information about their arrangements with fund managers. A requirement on IGCs to report on the firm's approach to stewardship will encourage providers to be more proactive and innovative in how they engage with fund managers and underlying investee companies.

3.18 We want IGCs to do more than simply publish their firm's policies on these matters. IGCs should report on what they think about the adequacy and quality of the policies, in relation to the products that they oversee. If a firm does not have a policy, the IGC must report on the firm's reasons why and raise any concerns with the firm. So, we propose to clarify these things in our new rules and guidance for IGCs.

Q1: Do you agree that IGCs should report on the adequacy and quality of their firm's policies on ESG issues, member concerns and stewardship?

Requiring IGCs to report on the firm's implementation of its policies

3.19 A firm may have a policy but in practice not implement it. Independent oversight of how the firm has implemented its policies will help make sure that it follows them. So, in line with the DWP, we propose to require IGCs to report on how the firm has implemented its policies on the above issues. This would include what IGCs think about the adequacy and quality of implementation.

Q2: Do you agree that IGCs should report on how the firm has implemented its policies on ESG issues, member concerns and stewardship?

Application to pathway solutions

3.20 In the next chapter of this consultation paper, we also propose that the remit of IGCs is extended to oversight of pathway solutions. Pathway solutions are similar to workplace pension default strategies in that they will be used by non-advised and generally less engaged consumers. The investments in pathway solutions may be held for many years, even though they are for use in drawdown.

3.21 We think that the same need for oversight of the firm's policies on ESG issues, member concerns and stewardship exists for pathway solutions as it does for workplace personal pensions. So, we propose to require IGCs to report on the firm's policies on the above issues, and their implementation, for pathway solutions as well as workplace personal pensions.

> **Q3:** **Do you agree that IGCs should report on the firm's policies on these issues for both pathway solutions and workplace personal pensions?**

Requirement to make IGC annual reports publicly available

3.22 Under our existing rules, firms must make the annual report of the IGC publicly available. Firms generally do this by publishing the annual report on the firm's website. However, IGC annual reports are not always easy to find and the firm may not also publish prior year reports for comparison.

3.23 We think it would be helpful for consumers and other interested parties for IGC annual reports to be appropriately prominent on the firm's website, with prior year reports for comparison. We consider that the annual report should be prominent in the context of other material on workplace personal pensions and pathway solutions.

3.24 We propose to require firms to make publicly and prominently available the 3 most recent annual reports of the IGC. We propose related guidance that a firm may do this by publishing the reports on its website in an appropriately prominent position.

> **Q4:** **Do you agree that firms should make the IGC's annual report publicly and prominently available, with 2 prior year reports for comparison?**

Guidance for firms on long-term investment decision-making

3.25 We propose related guidance to clarify how firms should think about ESG risks and member concerns in investment decision-making. Like the Law Commission, we distinguish between financial and non-financial matters. Firms should always take into account financially material ESG risks including climate change. Firms may take into account the non-financial concerns of relevant consumers, provided that those consumers generally share the concern and where there is no significant risk to consumer outcomes.

3.26 The Law Commission's recommendations were about workplace pension schemes only, but we think that this guidance applies more widely. So, we propose applying it to all firms that provide pension products and all life insurers that provide investment-based life insurance products, for investment decisions made on behalf of consumers. This would include non-workplace pensions and long-term investment products, like endowments, where the design of the product involves making investment decisions for a target market.

> **Q5:** **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?**

4 Investment pathways: IGC oversight of value for money

4.1 In this chapter, we propose extending the remit of IGCs and (GAAs)[6] to provide independent oversight of the value for money of the firm's pathway solutions.

Background to investment pathways

4.2 Since the introduction of the pension freedoms, consumers can access their pensions in several ways. They can buy an annuity, enter drawdown, take uncrystallised fund pension lump sums (UFPLS) or take all their pension as cash.

4.3 We have already introduced several requirements on pension providers to help consumers make decisions about which option - or options - to choose. These include requirements for:

- at least 1 'wake up' pack, setting out the different options available at retirement
- retirement risk warnings
- prompts to access free and impartial Pension Wise guidance
- clear information in a Key Features Illustration about the costs and charges associated with moving into drawdown
- a strong nudge to shop around when purchasing an annuity

4.4 Our proposed investment pathways remedy is aimed at consumers who, having received the above prompts, decide to access their pensions through drawdown without taking advice. It is designed for non-advised consumers, but advised consumers may also choose to invest in the investment solutions of investment pathways ('pathway solutions').

4.5 In June 2018, we published our first consultation paper (CP18/17) on proposed changes to our rules and guidance coming out of our Retirement Outcomes Review (ROR). Among other things, we proposed (for discussion rather than consultation) that firms with non-advised consumers entering drawdown be required to offer a range of investment pathways, to help consumers choose investment solutions that meet their needs and objectives in drawdown.

4.6 In January 2019, we published our second consultation paper (CP19/5) on proposed changes to our rules and guidance to require investment pathways. We proposed that providers 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. For each of these objectives, larger drawdown providers must offer a single investment solution.

6 As footnoted in Chapter 3, where we say IGCs we mean Governance Advisory Arrangements (GAAs) as well, unless we state otherwise. We explain GAAs in paragraphs 4.41 – 4.43 of this chapter.

Feedback on previous proposals to extend IGC remit to investment pathways

4.7 In CP18/17, we explained that we intended to extend the IGC regime to investment pathways. We said that our view was that less engaged, non-advised consumers were most likely to use investment pathways. As a result, we believed that independent oversight of the appropriateness, quality and charges of the pathway solutions of investment pathways might be in the interests of these consumers. We asked for views on:

- whether we should extend the remit of IGCs to investment pathways
- whether we should extend the remit of IGCs more widely, to other or all pensions decumulation products
- whether there should be a carve-out for firms only serving advised consumers, or those in less need of protection, and how this might operate in practice

Oversight of pathway solutions

4.8 In CP19/5, we summarised the feedback that we received. Consumer and professional bodies were generally supportive. A few providers were also supportive, while others said that we should think more about the impact on smaller providers. Other respondents said that we should think about deferring a decision until we have findings from our work on non-workplace pensions.

4.9 Most providers were against extending the IGC regime to investment pathways, because of the cost and because they thought that governance should be the sole responsibility of the firm. Many also said that they were concerned that extension into the decumulation phase would distract from IGCs' primary focus on the accumulation phase.

4.10 Feedback included the suggestion of independent representation on the firm's board, with a specific remit to review value for money, mirroring our remedy for authorised funds. A respondent thought that firms that do not have an existing IGC should have a choice between setting up an IGC and independent representation on the firm's board.

4.11 Some respondents thought that increasing the workload of IGCs could reduce their effectiveness. A respondent noted that decumulation is much more complicated than pre-retirement accumulation, with many possible solutions for different levels of investment risk, taking into account the need for income stability and sustainability, or other drawdown objectives.

Oversight of other decumulation products

4.12 A large majority of providers and professional bodies thought that extending the remit of IGCs to other decumulation products would be disproportionate where the consumer is advised or has actively chosen the product. A respondent noted that drawdown products present the most risk of consumer harm because of their inherent flexibility.

4.13 A small number of respondents thought that all decumulation products should be overseen by IGCs so that these products would be subject to the same level of scrutiny.

Carve outs for firms only serving certain customer groups

4.14 The majority of respondents who answered this question supported a carve out for advised consumers. Some respondents clarified that the carve out should only apply to firms serving consumers advised at the point of entering drawdown.

4.15 Some respondents highlighted the practical difficulties of applying other forms of carve out, such as a carve out for high net worth customers, adding that some of these consumers may also be in need of protection.

4.16 Several respondents thought that the same level of protection should apply to all consumers, both advised and non-advised. However, some of these respondents did not think that IGCs should be extended to investment pathways.

Our response

Oversight of pathway solutions

4.17 We have considered the feedback we received. It has not changed our view that IGC oversight will be in the interests of consumers with pathway solutions. As we said in CP19/5, many of the larger providers offering pathway solutions will already have an IGC for workplace personal pensions. These larger firms will account for most consumers invested in pathway solutions.

4.18 We have thought about the cost of our proposals (see Annex 2 for our Cost-Benefit Analysis). On an industrywide basis, we estimate that the cost of extending the remit of IGCs represents under 1 basis point (one hundredth of 1 percent) of total assets under management in workplace personal pensions and (in the future) pathway solutions. We think the benefit of extending IGC oversight is worth the cost. We recognise that smaller providers offering pathway solutions are less likely to have an existing IGC and would need to establish one. We set out below a proportionate approach for firms with smaller numbers of non-advised consumers entering drawdown.

4.19 We have also thought about the alternative approach of applying our AMMS remedy for authorised funds to pathway solutions. For pension products, the firm's board often has responsibility for various other products, as well as other responsibilities. It may not be practical to require independent non-executive directors solely for decisions about pathway solutions.

4.20 We do not propose to defer a decision on IGC remit extension until we have findings from our non-workplace pensions work. We think that IGCs should be in place in time to assess the initial designs of pathway solutions, before they are made available to consumers.

4.21 We recognise that our proposals will increase the workload of existing IGCs. Our proposals include guidance that providers should make sure that the IGC is appropriately resourced and supported.

Oversight of other decumulation products

4.22 We agree that consumers who are advised (and continue to be advised) or who have carefully selected a decumulation product (and continue to be engaged with their choice) are less likely to need protection from poor value products. We do not plan to extend the remit of IGCs to other decumulation products at the moment.

Carve outs for firms only serving certain customer groups

4.23 We expect some advised consumers to invest in pathway solutions, even though they are designed with non-advised consumers in mind. An adviser may think that a pathway solution is appropriate for their client's needs. So, advised consumers in pathway solutions will also benefit from the protection of an IGC, since IGCs will be considering the value for money of pathway solutions regardless of whether or not the consumers are advised.

4.24 We have considered further carve outs for certain customer groups, including advised consumers. We have concluded that these are likely to be difficult to implement in practice and may have unintended consequences. We do not propose such measures at the moment.

4.25 Under our existing proposals in CP19/5, firms are not required to implement investment pathways if they allow only advised consumers to enter drawdown. Firms that do not offer pathway solutions would not be required to have an IGC.[7]

A new duty for IGCs to oversee the value for money of pathway solutions

4.26 We propose rules to require that the terms of reference for an IGC include a new duty to assess the value for money of pathway solutions.[8] We propose that IGCs and GAAs must assess, at a minimum, the following:

- whether the pathway solutions offered by the firm:

  1. are designed and managed in the interests of pathway solution investors
  2. have clear statements of aims and objectives

- whether the characteristics and net performance of pathway solutions are regularly reviewed by the firm to ensure alignment with the interests of pathway solution investors and that the firm takes action to make any necessary changes
- whether core financial transactions are processed promptly and accurately
- the levels of charges borne by pathway solution investors
- the direct and indirect costs incurred as a result of managing and investing, and activities in connection with the managing and investing of, the drawdown funds of pathway solution investors, including transaction costs; and
- whether the communications to pathway solution investors are fit for purpose and properly take into account their characteristics, needs and objectives

4.27 An IGC must weigh up the quality of the pathway solution and associated services against the costs and charges paid by the consumer. We have aligned our proposed requirements with what IGCs must already do in assessing the value for money of workplace personal pensions. They can choose to look at other factors as well, depending on the nature of the pathway solutions offered and the needs, characteristics and objectives of their firm's retail clients.

7 For example, firms that refer non-advised consumers to another provider, so that the consumer becomes a customer of that other provider, or to the Money and Pensions Service drawdown comparator tool, in respect of all the investment pathway objectives

8 In our proposed rules we use the defined term 'pathway investment' for pathway solution, to be consistent with our proposed rules for investment pathways in CP19/5

4.28 As for workplace personal pensions, IGCs will have the power to raise any concerns they may have directly with the governing bodies of providers (typically the board) and providers must respond to these concerns. An IGC may escalate its concerns to the FCA, where the IGC considers that the firm has not satisfactorily addressed its concerns, may alert relevant scheme members and employers, and may make its concerns public.

4.29 We also propose a minor rule change to clarify that IGCs must consider whether communications to members are fit for purpose and properly take into account their characteristics, needs and objectives, in assessing the value for money of workplace personal pensions. In practice, most IGCs already do this.

4.30 As set out in Chapter 2, we have joint work with TPR underway on value for money. This may result in more prescriptive rules and guidance on what firms and IGCs must do in assessing value for money.

Resources and support

4.31 Our proposed rules place new responsibilities on existing IGCs for which they may need additional expertise and support. We propose guidance that a firm should provide resources and support to its IGC for these new responsibilities.

The providers covered by these proposals

4.32 Our proposals cover all drawdown providers offering pathway solutions. Some providers will already operate an IGC for their workplace personal pension business. Other providers will need to establish an IGC if they choose to implement investment pathways and offer pathway solutions to consumers.

Firms using the pathway solutions of other firms

4.33 Our intention is that all consumers invested in the pathway solutions of investment pathways benefit from the protection of an IGC. Only firms offering pathway solutions to consumers will be required to have an IGC.

4.34 We expect that most providers implementing investment pathways will manufacture the pathway solutions they offer to their customers. However, under our proposed rules in CP19/5, a drawdown provider may offer their customers pathway solutions manufactured by another firm.

4.35 A provider that offers another firm's pathway solutions is likely to levy charges, and be responsible for administration and communications to customers. As a firm offering pathway solutions to consumers, it will be required to have an IGC. The IGC would assess whether the pathway solutions and associated services are appropriate and good value for its own firm's target market, taking into account all the costs and charges paid by customers.

4.36 We recognise that the IGC can't directly challenge the firm manufacturing the pathway solutions. The IGC must raise any concerns with its own firm. That firm may then ask the manufacturer for changes or it may decide to use another manufacturer.

4.37 If a provider manufactures pathway solutions and offers them to its own customers, and also allows other firms to offer its pathway solutions, its IGC would focus on the firm's own customers and target market. The other firms would also be required to have IGCs, focused on their respective firm's customers including future customers.

4.38 Under our proposed rules in CP19/5, it is possible for a firm to manufacture pathway solutions for other firms but not offer them to consumers itself. In this scenario, the firm will not be required to have an IGC. The consumers using those pathway solutions will be protected by the IGCs of the firms offering them.

Q6: **Do you agree that we should focus our requirement for an IGC on firms offering pathway solutions to consumers?**

Firms with smaller numbers of non-advised consumers

4.39 Under our existing proposals in CP19/5, firms may choose to require that all consumers take advice before entering drawdown, so there would be no requirement to offer investment pathways. Firms that do not offer pathway solutions will not be required to have an IGC. We expect that some SIPP operators may choose this approach.

4.40 Also in CP19/5, providers with fewer than 500 non-advised consumers entering drawdown per year don't need to provide their own pathway solutions. They may refer non-advised consumers entering drawdown to another firm's pathway solutions (so the consumer becomes a customer of that other firm), or to the drawdown comparison tool that will be operated by the new Money and Pensions Service. These firms also will not be required to have an IGC.

Governance Advisory Arrangements

4.41 As a proportionate alternative to an IGC, we propose to allow firms to use a GAA for pathway solutions, as they can for workplace personal pensions. GAAs are provided by a third party, typically a professional trustee firm. As the third party may provide GAAs for multiple firms at once, and there is less work involved per firm, the cost of a GAA is much lower than the cost of an IGC.

4.42 We propose that a firm thinking about using a GAA must consider whether it would be appropriate, taking into account the expected number of consumers using its pathway solutions, the expected assets under management, and the complexity and nature of its pathway solutions. We propose guidance to help firms with this assessment. A firm that already has a GAA for workplace personal pensions, and intends to offer pathway solutions for a significant number of consumers, may need to establish an IGC instead.

4.43 There are currently 3 third party GAA providers and around 17 GAAs. Our proposals will mean extra demand for GAAs. This may encourage more third-party firms to think about supplying GAAs.

Proportionality

4.44 We recognise that the cost of a GAA may pass through to consumers. For firms with small numbers of customers using pathway solutions, that cost may be significant on a per customer basis. However, we think that all consumers using pathway solutions should have the protection of an IGC or GAA.

4.45 Some firms might be deterred from offering pathway solutions because of the additional cost of our proposals. If we find that a lot of firms decide not to offer pathway solutions for this reason, and we think that there is consumer harm as a result, we will consider changes to our approach.

Q7: **Do you agree with our proposed approach for providers with smaller numbers of non-advised consumers entering drawdown?**

Initial design of pathway solutions

4.46 The initial design of a pathway solution is important, as it will be costly for firms and potentially disruptive for consumers to make changes afterwards. So, we propose that IGCs[9] must assess the value for money of pathway solutions before they are offered to consumers. This means IGCs must be in place in time to think about the initial designs.

4.47 We plan to apply the requirement for firms to offer investment pathways 12 months after we publish our final rules and guidance for investment pathways, which we plan to do by the end of July 2019. We will confirm in our policy statement following this consultation when a firm that has decided to offer pathway solutions must have an IGC in place.

4.48 Where a provider intends to offer pathway solutions manufactured by another firm, the offering provider's IGC will need to consider the proposed pathway solutions before they are offered to the offering provider's consumers.

Q8: **Do you agree that IGCs must be in place in time to assess the initial designs of pathway solutions?**

9 As footnoted in Chapter 3, where we say IGCs we mean Governance Advisory Arrangements (GAAs) as well, unless we state otherwise

5 Discussion and next steps

5.1 In this chapter, we discuss our observations on the practices and behaviour of IGCs and GAAs[10]. We invite views and set out next steps.

What we have seen

Legacy Audit Progress Review

5.2 Following the OFT's market study on workplace pensions, an Independent Project Board (IPB) was established to conduct an audit of legacy workplace pension schemes. In 2015, the IPB found that approximately £26bn of pension savings was potentially at risk of poor value for money. The IPB recommended that providers agree actions with their IGCs to reduce costs and charges per year to 1% or less, or explain why not (some legacy products include valuable guarantees).

5.3 In 2016, we conducted a joint review with the DWP of progress by firms, IGCs and trustees in reducing costs and charges (our Legacy Audit Progress Review). For an estimated two thirds of the £26bn of pension savings potentially at risk of poor value for money, costs and charges had been, or were about to be, reduced to a level of 1% or less. While we were satisfied that significant progress had been made, there was still work to be done.

5.4 In 2017, we reported that costs and charges had been reduced to a level of 1% or less for an estimated £25bn of the £26bn of pension savings potentially at risk. Over a million consumers were now subject to lower charges than before.

5.5 This was an early and important test of the IGC regime. Overall, we found that IGCs had been generally effective in agreeing strong and timely actions to address poor value in relation to the remit they had been given. However, we found that some IGCs could have been more proactive and rigorous in getting providers to take strong action more quickly.

5.6 We deferred our planned 2017 review of IGC effectiveness because of other priorities and our findings from our Legacy Audit Progress Review. We plan to review IGC effectiveness in 2019/20.

More recent observations

5.7 We have engaged with IGCs and GAA providers and seen their published annual reports. We also looked at ShareAction's review of IGC annual reports published in 2017 and met with ShareAction to discuss their findings.[11]

5.8 We have not seen any reasons not to propose extending the remit of IGCs. But we have seen a lot of variation in how IGCs have assessed value for money and what they have done. The observations highlighted below are not intended to be comprehensive nor have we considered what an IGC might have done 'behind the scenes' in meetings with the provider.

10 As footnoted in Chapter 3, where we say IGCs we mean Governance Advisory Arrangements (GAAs) as well, unless we state otherwise
11 ShareAction's review, published in February 2018, looked at how effectively and transparently IGCs reported on their work in 2017

Independence and evidence of challenge

5.9 IGCs must act independently of the provider to be effective. We require a majority of independent IGC members, including an independent Chair, and that the provider must conduct an open and transparent recruitment process in appointing independent members.

5.10 An indication of independence is how strongly an IGC is challenging the provider on identified issues. In their annual reports, IGCs must set out the concerns that they have raised. We have seen some good examples of how IGCs have challenged their firms, how the firms have responded, and the implications for members.

5.11 In a few cases, very senior provider employees have been appointed to the IGC. Firm-appointed IGC members must act solely on behalf of scheme members in their role on the IGC. But very senior firm employees could have too much influence over an IGC. We think this may weaken an IGC's independence.

5.12 Most independent IGC members come from the pensions industry. These members have the background and expertise to assess complex pensions issues. Some are professional trustees of occupational pension schemes and bring their expertise to the IGC. But a more diverse mix of IGC members, and more consumer representatives as independent IGC members, may offer new perspectives.

Assessing value for money

5.13 In their annual reports, IGCs must set out their opinion of the value for money of their provider's workplace personal pension schemes. Our rules prescribe what IGCs must consider, at a minimum. IGCs may think about other factors as well.

5.14 We have seen examples of reports that set out very clearly how the IGC has made its assessment, with a clear framework and scoring system. Other reports provide less explanation. IGCs may also weigh factors differently, or consider additional factors.

5.15 We have also seen evidence of IGCs thinking about the market competitiveness of their provider. However, there is not consistency in how market competitiveness is assessed nor the basis of comparison.

5.16 In all the IGC annual reports we have seen, IGCs think about the value for money of the default investment strategies of their provider's schemes, as we require. However, some IGCs appear not to have assessed default investment strategies that have been designed by an employer's adviser, like an Employee Benefit Consultant, rather than by the provider itself. Our rules require the IGC to assess all default investment strategies, including those designed by an employer's adviser.

Benchmarking

5.17 Benchmarks can be a valuable tool for assessing relative value. A group of IGCs has started important work to develop benchmarks for workplace personal pensions, with resource and support from providers.

5.18 We support the industry collaborating to develop a benchmarking framework for workplace personal pensions. Strong and well-constructed benchmarks should help IGCs compare their respective providers with the wider industry.

Transparency and comparability

5.19 We want IGC annual reports to increase transparency and encourage comparison between schemes. Their publication should allow interested scheme members, employers and consumer groups to scrutinise an IGC's work and the provider's response to any concerns raised.

5.20 These different audiences have different needs. Some IGCs provide 2 reports: a short, accessible report designed with consumers in mind, and a longer report with data and analysis. We welcome this approach.

5.21 All the IGC annual reports we have seen include some information on costs and charges. However, the reports do not always include the detail that would allow informed comparisons between providers, and between the different schemes offered by the same provider. Where detailed information is presented, there is no common framework.

Governance Advisory Arrangements

5.22 GAAs have the same duty as IGCs to assess and report on the value for money of the provider's workplace personal pension schemes. We have seen evidence of objective and critical assessments by GAAs, concerns being raised with the provider, and the provider taking action.

5.23 Most GAAs are currently provided by PTL, which is also a professional trustee firm for pension schemes. Professional trustee firms provide governance for occupational pension schemes and are appointed by the employer. For both GAAs and occupational pension schemes these firms must act independently of the body appointing it.

Discussion

5.24 As set out in our joint Pensions Strategy with TPR, we planned work on value for money in workplace pension schemes. This work is now underway. We are developing a shared view of what good looks like in workplace pension schemes and how value for money should be assessed. This work may mean more prescriptive rules and guidance on value for money for firms and IGCs.

> **Q9:** **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?**

5.25 We recognise that what counts as good value for money may change over time. Charges may decrease and quality increase, because of innovation and technological change, competition, and changes to regulatory requirements. This means that a pension product that was considered good value for money when it was sold may no longer be.

5.26 This raises difficult issues. A consumer might be locked into a contract that no longer appears good value for money. But the provider may have been counting on the continuation of that contract when it first offered the product. If providers thought that they could not depend on contractual terms, they would take that into account when pricing future products.

5.27 This is relevant to how the market competitiveness of legacy pension products can be assessed. Should the basis of comparison be other legacy products, e.g. similar legacy products? Or should comparison be relative to products in the market today?

> **Q10:** **We welcome your view on what legacy pension products should be compared with, when assessing value for money.**

Next steps

5.28 As we set out in Chapter 2, we have several pensions workstreams underway that are relevant to IGCs and wider governance questions.

5.29 For the proposed extension of IGC remit set out in this consultation paper, we will consider the responses that we receive and plan to publish our policy statement and final rules in Q4 2019.

Annex 1
Questions in this paper

Q1: **Do you agree that IGCs should report on the adequacy and quality of their firm's policies on ESG issues, member concerns and stewardship?**

Q2: **Do you agree that IGCs should report on how the firm has implemented its policies on ESG issues, member concerns and stewardship?**

Q3: **Do you agree that IGCs should report on the firm's policies on these issues for both pathway solutions and workplace personal pensions?**

Q4: **Do you agree that firms should make the IGC's annual report publicly and prominently available, with 2 prior year reports for comparison?**

Q5: **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?**

Q6: **Do you agree that we should focus our requirement for an IGC on firms offering pathway solutions to consumers?**

Q7: **Do you agree with our proposed approach for providers with smaller numbers of non-advised consumers entering drawdown?**

Q8: **Do you agree that IGCs must be in place in time to assess the initial designs of pathway solutions?**

Q9: **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?**

Q10: **We welcome your view on what legacy pension products should be compared with, when assessing value for money.**

Q11: **Do you agree with the conclusion and analysis set out in our cost benefit analysis?**

Annex 2
Cost benefit analysis

Introduction

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made.'

2. This analysis presents estimates of the significant impacts of our proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide estimates of outcomes in other dimensions. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement about the appropriate level of consumer protection, taking into account all the other impacts we foresee.

Problem and rationale for the intervention

3. As recognised in our previous CBAs on interventions affecting markets for pension products, the need for regulatory interventions arise from the interplay of "standard" market failures (e.g. asymmetric information and market power) with biases affecting behaviour on the demand side (e.g. present bias and inertia).[12]

4. The proposed interventions aim to reduce the potential for consumer harm arising from:

- High prices and low quality – the harm arising from products that have excessive charges, which over time can have a substantial negative impact on outcomes, or are poor quality e.g. have inappropriate investment strategies or are poorly administered.
- Buying unsuitable products – the harm arising from product features that are not aligned with a consumer's retirement objectives or preferences in relation to ESG issues.
- Unmet needs – the harm arising from a lack of transparency of a firm's policies in relation to ESG issues, member concerns and stewardship, when some consumers may want to take these policies into account.
- Reduced consumer confidence – the harm arising from an erosion in consumer confidence in pensions, if consumers with workplace personal pensions and pathway solutions suffer poor outcomes.

5. We require Independent Governance Committees (IGCs) and Governance Advisory Arrangements (GAAs)[13] to help curb the impact of asymmetric information, misalignment

12 Our Occasional Paper 'Applying behavioural economics at the Financial Conduct Authority' (OP No.1) classifies behavioural biases and our Occasional Paper 'Economics for Effective Regulation' (OP No.3) sets out how interactions between behavioural bias and different types of market failures may harm consumers.

13 In this CBA, where we say IGCs we mean Governance Advisory Arrangements (GAAs) as well, unless we state otherwise.

of incentives and barriers to switching. These features are exacerbated by the tendency of consumers to remain with the status quo, to procrastinate when presented with a choice, and to neglect the long-term consequences of their actions or inaction.[14]

6. Our proposed rule changes extend the duties of IGCs to include:

- reporting on firms' policies on Environmental, Social and Governance (ESG) issues,[15] member concerns, and stewardship, for the products that IGCs oversee
- independent oversight of the value for money of the pathway solutions of investment pathways

7. We consider further below the features of these areas and how our proposals aim to prevent consumer harm.

Information asymmetries and misalignment of incentives

8. The complexity of pension products, both their costs and quality, make decision making on value for money very difficult for consumers. Consumers are less informed than providers about the characteristics of pension products, including investment strategies and charges.

9. Both access to and comprehension of information can be challenging for consumers. This means they have limited ability to exert pressure on employers and providers to revise choices in the accumulation phase, and to select the most appropriate product when moving to decumulation. Furthermore, many employers lack the capability, and/or the incentive, to ensure that members of their schemes receive value for money in the long term.

10. In markets that work well, competition between firms acts to drive prices down and quality up. But in markets where the demand side is very weak, firms have limited incentive to ensure that their products offer value for money. Consumers are at risk of excessive charges and poor quality products.

11. Firms also have limited incentive to take into account ESG risks and opportunities, and to engage with consumers on these issues. The provision of information, engagement with consumers, and consideration of ESG issues in investment strategies and decision making, require additional effort which may not be compensated by higher revenues.

12. IGCs are better placed than most consumers to access and process information to assess the value for money of drawdown propositions. IGC oversight should increase the likelihood that pathway solutions deliver good financial outcomes for non-advised consumers in pension drawdown.

13. IGCs are also better placed than most consumers to consider the quality and adequacy of firms' policies on ESG issues, member concerns and stewardship. IGCs can raise concerns on behalf of consumers, and can also facilitate consumer comprehension of firms' policies on these matters.

14 See pages 38-40 of our Consultation Paper 'Proposed rules for Independent Governance Committees' (CP14/16)

15 ESG issues include how companies are acting to limit climate change, the working conditions of employees, and whether pay awards can be justified. In investment strategies and decision making, ESG factors can be important to the sustainability of investment performance and ethical impact of investments.

Behavioural biases

14. Insights from behavioural economics highlight biases that make it difficult for consumers to engage with pension products and make choices aligned with their own interests. For example:

- Reference dependence and loss aversion may limit consumers' willingness to challenge the status quo of their existing scheme, and the choices presented by their provider when moving from accumulation into a drawdown product.
- Present bias may mean that consumers procrastinate rather than engage with decisions affecting their pensions. They may put off assessing the value for money of proposed schemes and the alignment of investment choices with their own preferences, for example in relation to environmental impact.
- Framing, salience and limited attention may mean that consumers cannot effectively assess the adequacy of pathway solutions and consider firms' policies on ESG issues, member concerns and stewardship, in relation to their preferences and goals.

15. IGCs have the expertise to help protect consumers from the harmful impact of these biases by improving value for money and helping to make sure that firms invest responsibly.

Market power

16. The Retirement Outcomes Review identified the market power of accumulation providers when proposing drawdown products to scheme members.

17. The behavioural biases outlined above, combined with the convenience of remaining with the same provider, mean that consumers put less effort into searching for a better deal and switching to a different provider. As a consequence, competition among drawdown providers may not work in the interest of consumers.

18. While investment pathways should improve comparability of propositions offered by different providers, it is likely that many consumers will still find it difficult to engage with decumulation choices. Extending the remit of IGCs is therefore likely to help protect these less engaged consumers from risks, especially in relation to excessive charges and poor quality or inappropriate pathway solutions and associated services.

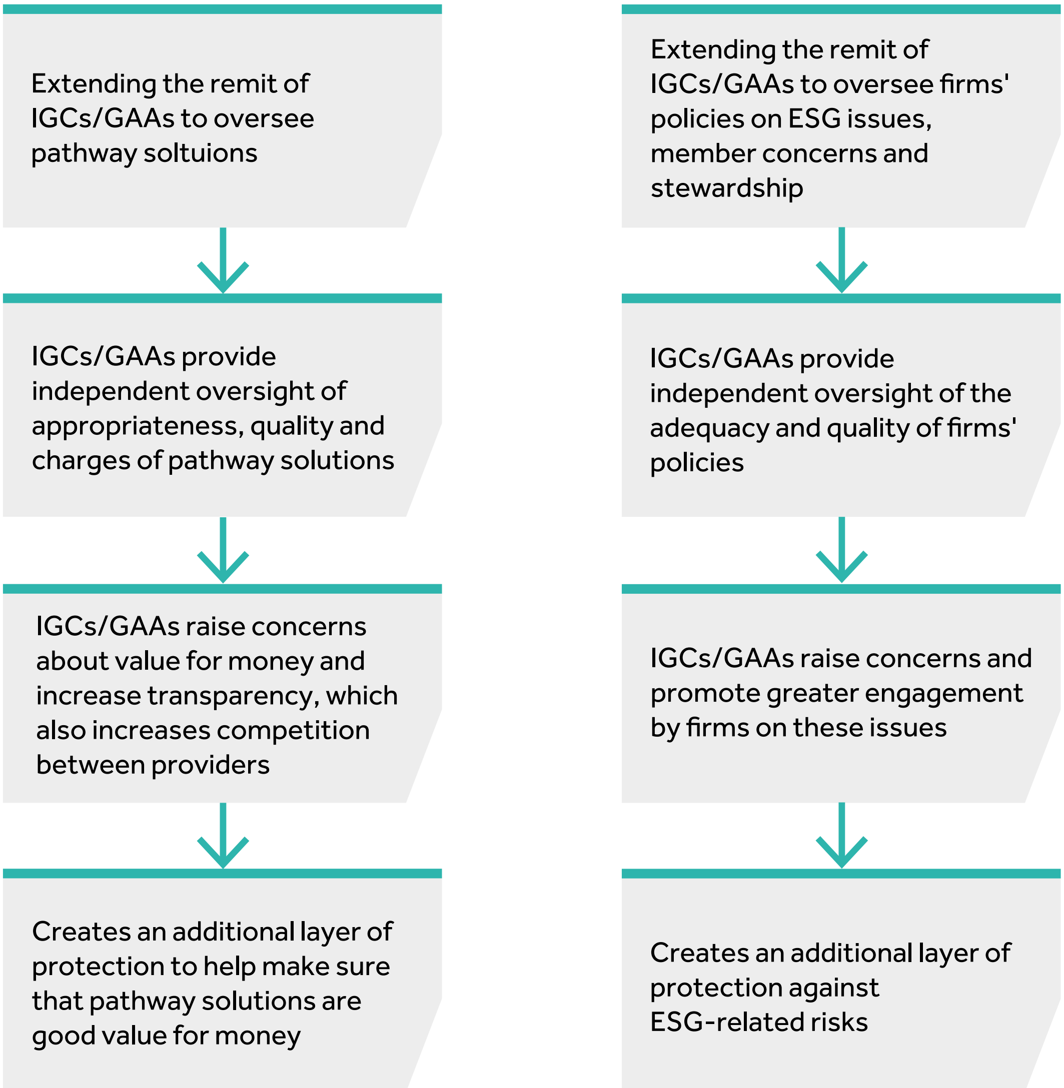
Baseline and summary of our intervention

19. IGCs are not currently required to look at firms' policies on ESG issues, member concerns and stewardship, as part of their existing duty to assess the value for money of workplace personal pensions. To the extent that they already do, our proposals do not represent any significant increase in cost. IGCs do not currently look at the value for money of pathway solutions. Our baseline is that without our intervention there will be no additional IGC scrutiny of firms' policies on ESG issues, member concerns and stewardship, and of the value for money of pathway solutions.

20. We think that extending the remit of IGCs to provide independent oversight of firms' policies on ESG issues, member concerns and stewardship will have a positive impact on how firms assess risk. The ongoing scrutiny provided by IGCs will encourage providers to develop policies around ESG factors, and be more proactive and innovative about how they engage with fund managers and investee companies on these issues. This may help contribute to a more sustainable allocation of capital and resources across the real economy. Increased engagement with investee companies on governance issues will also encourage the management of these companies to deliver sustainable returns for investors.

21. Consumers with workplace personal pensions and pathway solutions will also benefit from increased transparency of the firm's policies on ESG issues, consumer concerns and stewardship, as they will be better informed about their provider's approach to sustainable investment and how consumer concerns have been taken into account.

22. The following diagram illustrates how we expect our proposed measures will reduce harm to consumers:



Key assumptions

23. We have based our estimates for the number of firms that will need an IGC/GAA for pathway solutions on:

- Information supplied in response to our Retirement Income Data Regulatory return (RIDR), which tells us which firms provide drawdown to non-advised consumers
- Our Retirement Outcomes Review survey of 71 SIPP operators that were not connected to an insurer, which included questions on whether the firm would be likely to implement pathway solutions

24. We have based our cost estimates on what we know about the cost to firms of existing IGCs and GAAs and from discussion with industry about the cost of our proposals.

25. We have estimated ranges for the average costs to affected firms for different types of cost. While we expect the average cost to fall within the range we estimate, the cost to an individual firm may fall outside this estimated range.

Firms affected by our proposals

Firms that already have, or will need to establish, an IGC

26. There are currently 16 firms with IGCs for workplace personal pensions. Firms that have larger or more complex workplace personal pension schemes must establish an IGC, rather than a Governance Advisory Arrangement (GAA) .[16]

27. In our analysis, we assume 15 firms with IGCs for workplace personal pensions, because we know that a particular firm may not need an IGC in the future due to changes to its business. These 15 firms are all larger firms.

28. We know that 1 of these 15 firms does not have drawdown customers, so we assume that this firm will not implement investment pathways. The IGC of this firm will consider its firm's policies on ESG issues, consumer concerns and stewardship ('consider the firm's policies') in relation to workplace personal pensions, in addition to its existing duty to assess the value for money of its firm's workplace personal pensions ('assess workplace personal pensions').

29. We assume that the other 14 larger firms with IGCs will offer pathway solutions because they have significant numbers of non-advised consumers entering drawdown. Under our proposals, the IGCs of these firms will both assess the value for money of pathway solutions ('assess pathway solutions') and consider the firm's policies in relation to both workplace personal pensions and pathway solutions, in addition to their existing duty to assess workplace personal pensions.

30. A small number of larger firms have non-advised customers entering drawdown, but do not have workplace personal pensions and therefore do not have an existing IGC. Most of these firms are likely to offer pathway solutions. We assume that 2 larger firms without an existing IGC will need to establish one. The IGCs of these firms will both assess pathway solutions and consider the firm's policies in relation to pathway solutions.

31. In addition, some larger firms that currently have a GAA for workplace personal pensions may offer pathway solutions for their non-advised consumers entering drawdown. We assume that 5 of these firms will establish an IGC in place of their existing GAA. The IGCs of these firms will both assess pathway solutions and consider the firm's policies, in addition to assessing workplace personal pensions.

16 A GAA is a proportionate alternative to an IGC

32. In summary, for firms that already have, or will need to establish, an IGC:

Have an existing IGC, will not offer pathway solutions	1 firms
Have an existing IGC, will offer pathway solutions	14 firms
No existing IGC/GAA, will offer pathway solutions, will need to establish an IGC	2 firms
Have an existing GAA, will offer pathway solutions, will establish an IGC in place of their existing GAA	5 firms

Firms that already have, or will need to establish, a GAA

33. There are currently 17 firms with GAAs for workplace personal pensions. We assume that 5 of these firms will offer pathway solutions and establish an IGC in place of their existing GAA (see Paragraph 31). We do not consider these 5 firms further in this section.

34. Of the remaining 12 firms, which are all smaller firms, we assume that 6 firms will not offer pathway solutions. The GAAs of these firms will consider the firm's policies in relation to their workplace personal pensions, in addition to assessing workplace personal pensions.

35. We assume that the other 6 firms will offer pathway solutions and continue to use their existing GAA. The GAAs of these firms will both assess pathway solutions and consider the firm's policies in relation to both workplace personal pensions and pathway solutions, in addition to assessing workplace personal pensions.

36. A much larger number of smaller firms that do not operate workplace personal pensions have non-advised consumers entering drawdown. We estimate that 51 smaller firms without an existing GAA (none have an IGC) will offer pathway solutions and will therefore need to establish an IGC or GAA (we assume a GAA) to assess pathway solutions and consider the firm's policies in relation to its pathway solutions. We explain below how we arrive at this estimate.

37. In our January 2019 Retirement Outcomes Review consultation paper (CP19/5), we estimated that 160 smaller firms, including self-invested personal pension (SIPP) operators, may have non-advised customers entering drawdown. (A small number of the 160 smaller firms have an existing GAA, which we take into account below). Our Retirement Outcomes Review remedies survey of 71 SIPP operators indicated that 39% would not implement investment pathways, instead choosing to restrict access to drawdown to advised consumers. 61% said either that they would implement investment pathways or that they were unsure. As we did in CP19/5, we have applied this 61% to the 160 smaller firms, and estimate that approximately 97 smaller firms implement investment pathways.

38. In addition, we expect that many of these 97 firms will not offer pathway solutions and therefore will not be required to have an IGC or GAA. This is because our proposed rules for investment pathways include an easement for these firms. CP19/5 estimated that approximately 40 of the 97 smaller providers will take advantage of this easement. We therefore estimate that the proposal to extend the IGC/GAA regime to pathways solutions will affect 57 smaller firms.

39. We have already assumed that 6 smaller firms with GAAs will offer pathway solutions and continue to use their existing GAA. So, we subtract these 6 firms from the 57 affected smaller firms. We therefore estimate that 51 smaller firms will establish a GAA to assess pathway solutions and consider the firm's policies in relation to its pathway solutions. The actual number may be substantially lower than this because earlier in our analysis we

included firms that said they were unsure whether they would implement investment pathways. Given this uncertainty, we assume the number will be in the range of 30-51 firms.

40. In summary, for firms that already have, or will need to establish, a GAA:

Have an existing GAA, will not offer pathway solutions	6 firms
Have an existing GAA, will offer pathway solutions	6 firms
No existing GAA, will offer pathway solutions, will need to establish a GAA	30 - 51 firms

Costs

Compliance costs to firms

41. We have identified two main categories of cost: one-off costs and ongoing costs.

42. We expect affected firms to incur the one-off costs of familiarising themselves with the policy documentation and conducting a legal review of the new requirements ('gap analysis'). These costs are small in relation to other costs. We also recognise that additional IGC/GAA meetings may be needed in the first year, since the IGC/GAA will be delivering against its new responsibilities for the first time, and the cost to the firm of providing information and support to the IGC/GAA may be higher in the first year. We have included in one-off costs an estimate of these learning costs, which are in addition to ongoing costs in the first year.

43. In addition, some firms will incur the one-off cost of establishing an IGC under our proposals. We expect a larger number of firms to establish a GAA, but we do not consider that the one-off cost of contracting with a third party for a GAA will be material.

44. Ongoing costs are the incremental costs that affected firms will incur yearly, such as the cost of the IGC/GAA overseeing pathway solutions and firm's policies on ESG issues, member concerns and stewardship, and the incremental annual cost to the firm of providing information and support to the IGC/GAA.

45. Overall, and across the industry, we estimate that one-off costs will be in the range of £4-10m per year and ongoing costs will be in the range of £8-15m per year. We explain below how we arrive at these estimated ranges.

One-off costs for firms which have, or will need, an IGC

46. We assume that 7 firms will need to establish a new IGC (see Paragraphs 30–31). These firms will have larger (in terms of anticipated number of customers and assets under management) or more complex pathway solutions.

47. In our Consultation Paper 'Proposed rules for independent governance' (CP14/16), published in 2015, we estimated that the cost of establishing a new IGC to oversee workplace personal pensions would range between £35,000-£465,000 per firm. This was based on estimates provided by firms. Since then, firms have established IGCs. Based on discussion with industry, in this CBA we assume that the average one-off cost of establishing a new IGC to oversee pathway solutions and report on the firm's policies will be in the range of £200,000-£400,000. The actual one-off cost of establishing a new IGC for some firms may be outside this range but

we think the average cost across firms is likely to fall within this range.

48. Firms will also need to familiarise themselves with new rules and complete a gap analysis to identify what they need to do to comply. Based on an approximately 30 page policy paper and an approximately 15 page legal instrument, and the application of our standard assumptions on staff involved,[17] we estimate familiarisation and gap analysis costs for larger firms at £1,584 per firm.

49. We also assume learning costs in the first year, as a one-off cost. We know that IGCs/GAAs for workplace personal pensions spent additional time in the first year as they learned about their firm's products and assessed product features for the first time. In this CBA, learning costs relate to the time and resource for IGCs/GAAs to familiarise themselves with the firm's pathway solutions and the firm's policies on ESG issues, member concerns and stewardship. Learning costs also relate to firms setting up processes to provide information and support on these areas to IGCs/GAAs.

50. Given what we know about the costs incurred by firms in relation to workplace personal pensions, we assume that average learning costs in relation to pathway solutions and the firm's policies on ESG issues, member concerns and stewardship will be in the range of 30%-50% of ongoing costs. We set out in Table 1 below assumed learning costs by category of firm.

One-off costs for firms which have, or will need, a GAA

51. We estimated above (Paragraphs 37–39) that 30-51 smaller firms may need to establish a GAA to assess pathway solutions and consider the firm's policies in relation to its pathway solutions. We think it is unlikely to be a higher number. We assume that the number of smaller firms that will need to establish a GAA will be in the range of 30-51 firms. These firms will have smaller (in terms of anticipated number of customers and assets under management) and less complex pathway solutions.

52. The cost of setting up a GAA is different in nature to setting up an IGC, since it does not involve recruiting new members. The main costs relate to selecting a third party GAA provider and agreeing the contract. We assume that the one-off cost of setting up a new GAA to oversee the firm's pathway solutions will be minimal.

53. Smaller firms will incur additional one-off costs related to familiarisation and gap analysis. Based on our standard assumptions applying for smaller firms (see Paragraph 45), we estimate this cost at £224 per firm.

54. As we did for IGCs, we have included an estimate of learning costs in the first year as a one-off cost. We assume that average learning costs in relation to the firm's pathway solutions and policies on ESG issues, member concerns and stewardship will be in the range of 30%-50% of annual ongoing costs. We set out in Table 1 below assumed learning costs by category of firm.

Table 1: Summary of one-off costs

17 The assumptions used to estimate these costs are based on a review of previous CBAs, internal consultation, and desk-based research, combined with consultation with firms and trade bodies, discussions with software vendors and the 2016 Willis Towers Watson UK Financial Services Report. To put a cost on time, we have sourced salary information for a range of occupations in financial services. In this context, we estimate hourly compliance staff salaries, including 30% for overheads, as: £66/hour for larger firms with an IGC and £43/hour for smaller firms with a GAA. We estimate that approximately 10 compliance staff at larger firms, and 2 at smaller firms, will take approximately 2 hours to read the policy document. We estimate that 2 legal staff at larger firms, and 1 at smaller firms, will take approximately 1 hour to review the legal instrument, with hourly costs of £66/hour and £52/hour, respectively.

Firms which have, or will need, an IGC	Firms with an existing IGC, not offering pathway solutions	Firms with an existing IGC, offering pathway solutions	Firms needing to establish an IGC, offering pathway solutions	Total
Cost of setting up an IGC	NA	NA	£200,000 - £400,000	
Familiarisation and gap analyses	£1,584	£1,584	£1,584	
Learning costs	£12,000 - £50,000	£63,000 - £220,000	£105,000 - £250,000	
Total per firm	£13,584 - £51,588	£64,584 - £221,584	£306,584 - £651,584	
Number of firms	1	14	7	22
One-off costs (IGCs)	£14,000 - £52,000	£0.9m - £3.1m	£2.1m - £4.6m	£3.1m - £7.7m

Firms which have, or will need, a GAA	Firms with an existing GAA, not offering pathway solutions	Firms with an existing GAA, offering pathway solutions	Firms needing to establish a GAA, offering pathway solutions	Total
Cost of setting up a GAA	NA	NA	Minimal	
Familiarisation and gap analyses	£224	£224	£224	
Learning costs	£2,400 - £12,500	£10,500 - £27,500	£19,500 - £42,500	
Total per firm	£2,624 - £12,724	£10,724 - £27,724	£19,724 - £42,724	
Number of firms	6	6	30-51	42 – 63
One-off costs (GAAs)	£16,000 - £76,000	£64,000 - £166,000	£0.6m - £2.2m	£0.7m - £2.4m

Total one-off costs	£30,000 - £128,000	£1.0m - £3.3m	£2.7m - £6.7m	£3.7m - £10.1m

Ongoing costs for firms which have, or will need, an IGC

55. The ongoing cost of existing IGCs for workplace personal pensions provides context for our estimate of the average cost of a new IGC for assessing the firm's pathway solutions and considering the firm's policies on ESG issues, member concerns and stewardship. In CP14/16, before IGCs had been established, we estimated the ongoing direct cost of operating an IGC at £105,000-£295,000 per year, based on estimates from firms. This cost represents the cost of independent IGC members and the opportunity cost of the time of firm employees appointed to the IGC, and the cost of any external advice necessary for committee business. It is before other costs to the firm of supporting the IGC.

56. Based on industry experience and discussion with industry, we now estimate that the average ongoing direct cost of operating an IGC is in the range of £175,000-£250,000 per year.

57. The ongoing direct cost of operating an IGC for pathway solutions may be less than for workplace personal pension schemes, because there may be fewer pathway solutions per firm, and workplace personal pension schemes may include complex legacy products. However, the new IGC will also have to consider the firm's policies on ESG issues, member concerns and stewardship in relation to pathway solutions. So, we assume that the average ongoing direct cost of operating an IGC for pathway solutions and the firm's policies will also be in the range of £175,000-£250,000 per year.

58. In addition to the direct costs of the IGC, the firm will incur other ongoing costs to support the IGC. These other costs include the cost of a secretariat, liaising with and providing information to the IGC, and senior management time. Since we understand from discussion with industry that, for workplace personal pensions, these additional costs are approximately the same as the direct costs of the IGC, we assume the same for a new IGC for pathway solutions. So, we assume that the average of other firm costs to provide information and support to the IGC will be in the range of £175,000-£250,000 per year.

59. Most larger firms that offer pathway solutions will already have an IGC in place for workplace personal pensions. These existing IGCs will need additional meetings or additional time in meetings to assess pathway solutions and consider the firm's policies. Based on discussion with industry, we assume that on average between 3 and 7 additional meetings will be needed. We assume that the average annual cost per firm for additional meetings and associated work will be in the range of £75,000-£150,000.

60. Since these existing IGCs are currently focused only on workplace personal pensions, they may need to seek external expertise or advice on drawdown and ESG issues (or a new member may be needed), to supplement their existing expertise. Based on what we know and views from the industry, we assume that the average additional cost of drawdown expertise or advice provided to the IGC will be in the range of £20,000-£50,000 per year, and that the average additional cost of ESG expertise or advice will be in the range of £10,000-£20,000 per year. We also assume average additional other firm costs to support the IGC in the range of £105,000-£220,000 per year (more secretariat support, more need for liaising with and providing information to the IGC, more senior management time).

61. We assume that one larger firm will have an existing IGC for workplace personal pensions, but will not offer pathway solutions. For this firm, we have again assumed additional IGC costs for considering the firm's policies on ESG issues, member concerns and stewardship. We assume a cost of the additional time and associated work to consider the firm's policies in the range of £10,000-£30,000 per year, an additional cost of ESG expertise or advice in the range of £10,000-£20,000 per year, and additional other firm costs, for providing information and engaging with the IGC about the firm's policies, in the range of £20,000-£50,000 per year.

Ongoing costs for firms which have, or will need, a GAA

62. Our analysis is based on what we know about the cost of existing GAA contracts for workplace personal pensions. We estimate that the average annual cost of an existing GAA contract is in the range of £25,000-£35,000. This is much lower than the cost of an IGC, because a third party GAA provider may provide GAAs for multiple smaller firms, and there may be less to assess per firm. The actual cost of a GAA contract for some firms may be outside this range but we think the average cost across firms with a GAA is likely to fall within this range.

63. We estimate above (Paragraphs 37-39) that 30-51 smaller firms may need to establish a GAA. To estimate the average cost of a GAA contract for pathway solutions, we start with the estimated average cost of £25,000-£35,000 for workplace personal pensions. We do not assume that the average GAA contract for pathway solutions will cost less than for workplace personal pensions, because both will involve smaller numbers of consumers and will be less complex to assess. Rather, we assume that there will be some additional cost per year to consider the smaller firm's policies, in relation to its pathway solutions. We therefore assume that the average cost of a GAA contract for pathway solutions will be in the range of £30,000-£40,000 per year. We assume that the average of other costs to the firm will be in the range of £35,000-£45,000 per year, for supplying information and engaging with the GAA.

64. We assume that 6 smaller firms offering pathway solutions will already have a GAA for workplace personal pensions, and will be able to continue to use a GAA because their pathway solutions are not intended for larger numbers of consumers and are not complex. However, these firms may need to pay more for their GAA contracts, to reflect additional GAA meetings (or longer meetings) and associated work to assess the firm's pathway solutions and consider the firm's policies on ESG issues, member concerns and stewardship. We assume that the average additional cost per firm will be in the range of £15,000-£25,000 per year. We have not assumed additional costs for drawdown or ESG expertise, because we expect the third party GAA provider to have this expertise. We assume that average additional firm costs to support the GAA will be in the range of £20,000-£30,000 per year (e.g. more time liaising with and providing information to the GAA, more senior management time).

65. For smaller firms that have an existing GAA but that do not offer pathway solutions, we assume that the average cost of additional GAA meetings (or longer meetings) to consider the firm's policies in relation to workplace personal pensions will be in the range of £3,000-£10,000 per year. We assume that average additional other firm costs to support the GAA will be in the range of £5,000-£15,000 per year.

Table 2: Summary of ongoing costs

Firms which have, or will need, an IGC	Firms with an existing IGC, not offering pathway solutions	Firms with an existing IGC, offering pathway solutions	Firms needing to establish an IGC, offering pathway solutions	Total
Cost of IGC members and external expertise/advice if necessary (IGCs newly established for pathway solutions)	NA	NA	£175,000 - £250,000 p.a.	
Additional meetings/time (for existing IGCs)	£10,000 - £30,000 p.a.	£75,000 - £150,000 p.a.	NA	
Drawdown expertise (for existing IGCs)	£0 p.a.	£20,000 - £50,000 p.a.	(included in above)	
ESG expertise (for existing IGCs)	£10,000 – £20,000 p.a.	£10,000 - £20,000 p.a.	(included in above)	
Other firm costs to support the IGC	£20,000 - £50,000 p.a.	£105,000 - £220,000 p.a.	£175,000 - £250,000 p.a.	
Total per firm	£40,000 - £100,000 p.a.	£210,000 - £440,000 p.a.	£350,000 - 500,00 p.a.	
Number of firms	1	14	7	22
Ongoing costs (IGCs)	£40,000 - £100,000 p.a.	£2.9m - £6.2m p.a.	£2.5m - £3.5m p.a.	£5.4m - £9.8m p.a.

Firms which have, or will need, a GAA	Firms with an existing GAA, not offering pathway solutions	Firms with an existing GAA, offering pathway solutions	Firms needing to establish a GAA, offering pathway solutions	Total
Cost of contract (GAAs establish for pathway solutions)	NA	NA	£30,000 - £40,000 p.a.	
Additional meetings/time (for existing GAAs)	£3,000 - £10,000 p.a.	£15,000 - £25,000 p.a.	NA	
Other firm costs to support the GAA	£5,000 - £15,000 p.a.	£20,000 - £30,000 p.a.	£35,000 - £45,000 p.a.	
Total per firm	£8,000 - £25,000 p.a.	£35,000 - £55,000 p.a.	£65,000 - £85,000 p.a.	
Number of firms	6	6	30 - 51	42 – 63
Ongoing costs (GAAs)	£48,000 - £150,000 p.a.	£210,000 - £330,000 p.a.	£2.0m - £4.3m p.a.	£2.2m - £4.8m p.a.
Total ongoing costs	£88,000 – £250,000 p.a.	£3.2m – £6.5m p.a.	£4.4m – £7.8m p.a.	£7.6m – £14.6m p.a.

66. We recognise that our proposals will have a proportionately bigger impact on smaller firms. While the cost of a GAA contract is lower than the cost of an IGC, smaller firms may have a much smaller number of customers than larger firms. In addition, larger firms are more likely to have an existing IGC. The incremental cost for smaller firms will be proportionately higher and this cost may pass through to consumers. However, we believe that all consumers, regardless of the size of their provider, should benefit from the same level of protection.

Direct costs to the FCA

67. We do not expect our proposed measures to lead to any significant direct costs to the FCA, as supervision and enforcement of the proposed rules will be undertaken using existing resources.

Benefits

68. Our proposals aim to help protect consumers with workplace personal pensions and pathway solutions from potentially poor outcomes.

69. We think that our proposals will have a positive impact on consumer welfare by creating an additional layer of protection from potentially poor value for money pathway solutions for pension drawdown. In CP19/5 we estimated that approximately 111,600 non-advised consumers per year enter drawdown or transfer assets already in drawdown. 75-80% of these consumers, about 84,000 to 89,000 people per year, may use investment pathways to select a pathway solution. These non-advised consumers are likely to be retail consumers who lack the expertise and engagement required to shop around.

70. Our proposals address the risk that, against this backdrop of weak demand-side pressure, firms may not always deliver good value for money. IGCs will help make sure that the newly introduced pathway solutions offer good value for money. IGCs will also promote greater

transparency of the cost and charges of pathway solutions, and their quality and suitability, thereby enabling IGCs, employers, consumer representatives and interested members of pension schemes to engage better with the providers.

71. We do not think it is reasonably practical to quantify the benefits of our proposals. This is because of the difficulty of quantifying the future consumer harm in the absence of our proposed extension of IGC remit. Our proposals aim to help protect consumers against the risk of poor quality pathway solutions, which do not yet exist, and to protect consumers against the long-term risk to their pension investments of ESG issues including climate change.

72. In our 2019 Sector View on Pensions Savings and Retirement Income, we estimated total assets under management (AUM) in workplace personal pensions in 2017 at £179bn. The total ongoing costs of our proposals, therefore, represents under 1 basis point of total AUM. We expect assets under management in workplace personal pensions and in pathway solutions to grow in the next 10 years, because of automatic enrolment and use of pathway solutions in the context of pension freedoms.

Benefits to the FCA

73. We expect to see some benefits arising from the presence of IGCs improving the consumer focus of providers (thus reducing the need for supervision) and improving the information available to supervisors on the firms they are supervising.

Conclusion

74. Our proposed interventions will help make sure that pathway solutions are good value for money and that firms properly take into account ESG-related risks. The value of these benefits is likely to be more than 1 basis point of the total AUM in workplace personal pensions and (in the future) pathway solutions. Therefore, we think that the benefits are likely to outweigh the costs.

Q11: **Do you agree with the conclusion and analysis set out in our cost benefit analysis?**

Annex 3
Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with several legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances 1 or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

4. This Annex includes our assessment of the equality and diversity implications of these proposals.

5. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to several high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: Compatibility statement

6. The proposals set out in this consultation are intended to advance the FCA's operational objective of securing an appropriate degree of protection for consumers. They also advance the FCA's operational objective to promote competition in the interests of consumers.

7. We think these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because they will help make sure that firms consider ESG issues when they make investment decisions on behalf of consumers with workplace personal pensions and pathway solutions, as well as help encourage good stewardship of investments. Our proposals will also promote greater transparency, which may increase competition between firms to design and monitor investment strategies that incorporate ESG factors and design

and maintain good value for money pathway solutions. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by s. 1F FSMA.

8. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

The need to use our resources in the most efficient and economic way

9. We have considered this principle and do not believe that our proposals will have a significant impact on our resources and the way we use them. Any work undertaken after implementation of our proposals - like the planned post-implementation review of the wider investment pathway proposals in CP19/5 - will form part of our future business planning.

The principle that a burden or restriction should be proportionate to the benefits

10. In Annex 1 we have set out our analysis of the costs and benefits of our proposals for consultation. Overall, we believe that our proposals are a proportionate response to the harm that we have found.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

11. We have considered this principle and do not believe our proposals undermine it.

The general principle that consumers should take responsibility for their decisions

12. While we believe that consumers should take responsibility for their decisions, in this instance our proposals are designed to protect less engaged consumers. They may also encourage greater consumer engagement, through the transparency of IGCs and GAAs reporting on the value for money of pathway solutions and firms' policies on ESG issues, member concerns and stewardship.

13. Under our proposals for investment pathways in CP19/5, non-advised consumers entering drawdown will choose an objective for their retirement savings, but will be placed in the pathway solution designed by a firm. In workplace personal pension schemes, the majority of consumers will not have made any active choice and will be in a default investment strategy. Many of these consumers, both in pathway solutions and in default investment strategies, are unlikely to be willing or able to take responsibility for decisions about how their pension savings are managed and invested. Our proposals are designed to protect their interests in relation to the value for money of pathway solutions and the sustainable growth of their investments in pathway solutions and workplace personal pensions.

The responsibilities of senior management

14. We have had regard to this principle and do not believe our proposals undermine it.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

15. We have had regard to this principle and do not believe our proposals undermine it. We believe that the consideration of ESG issues has general relevance across different kinds of business organisation making investment decisions on behalf of consumers. For our proposal to extend the remit of IGCs to pathway solutions, we have considered the possible impact on SIPP operators and other smaller providers, recognising their different business models.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

16. We have had regard to this principle and do not believe our proposals undermine it.

The principle that we should exercise of our functions as transparently as possible

17. We have had regard to this principle and do not believe our proposals undermine it.

18. In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA). We do not think this is relevant for our proposals.

Expected effect on mutual societies

19. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies than other authorised persons, or present them with any more or less of a burden than other authorised persons.

Equality and diversity

20. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to make sure that the equality and diversity implications of any new policy proposals are considered.

21. The outcome of the assessment in this case is stated in paragraphs 2.35 – 2.36 of the CP.

Legislative and Regulatory Reform Act 2006 (LRRA)

22. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance and think that our proposals are proportionate and will result in an appropriate level of consumer protection when balanced with the impact of affected providers.

23. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance, but this duty does not apply to regulatory functions exercisable through our rules.

Treasury recommendations about economic policy

24. We have had regard to the Treasury's recommendations under section 1JA FSMA. Our proposals are consistent with these recommendations, as they aim to improve outcomes for consumers in pathway solutions and workplace personal pensions, while supporting competition between providers operating in this market on issues made transparent by IGCs.

Appendix 1
Abbreviations used in this paper

AMMS	Asset Management Market Study
CBA	Cost Benefit Analysis
CP	Consultation Paper
DC	Defined Contribution
DP	Discussion Paper
DWP	Department for Work and Pensions
ESG	Environmental, Social and Governance
EU	European Union
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
FSMA	Financial Services and Markets Act 2000
GAA	Governance Advisory Arrangement
IGC	Independent Governance Committee
IPB	Independent Project Board
LC	Law Commission
LRRA	Legislative and Regulatory Reform Act 2006
OFT	Office of Fair Trading
PRA	Prudential Regulation Authority
ROR	Retirement Outcomes Review
SM&CR	Senior Managers and Certification Regime
SIPP	Self-Invested Personal Pension
SRD II	The Amended Shareholder Rights Directive

TPR	The Pensions Regulator
UFPLS	Uncrystallised Fund Pension Lump Sum
VFM	Value for Money

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 7948 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN

Appendix 2
Draft Handbook text

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FINANCIAL
CONDUCT
AUTHORITY

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk