

Driving value for money in pensions

Consultation Paper

CP20/9**

June 2020

How to respond

We are asking for comments on this Consultation Paper (CP) by **24 September 2020**.

You can send them to us using the form on our website at: www.fca.org.uk/cp20-09-response-form

Email:

cp20-09@fca.org.uk

Please do not post responses to us at the current time.

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1 Summary

Why we are consulting

- 1.1** We want to make it easier for Independent Governance Committees (IGCs) to compare the value for money (VfM) of pension products and services, enabling them to be more effective in assessing value for pension scheme members.
- 1.2** IGCs currently oversee the VfM 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 (building up pension savings) and of the investment pathway solutions that will have to be offered from 1 February 2021.¹ They act on behalf of consumers who are likely to be uninvolved or less engaged with their pension savings.
- 1.3** Firms which offer workplace personal pensions in accumulation, like life insurers and some self-invested personal pension (SIPP) operators, are currently required to have an IGC, or in some cases a Governance Advisory Arrangement (GAA). A GAA is a proportionate alternative to an IGC for firms with a smaller number of customers and less complex schemes. In this Consultation Paper (CP), where we say IGCs we mean GAAs as well, unless we state otherwise.
- 1.4** This consultation includes:
- feedback to our questions on whether there is a need for clearer rules and guidance on how IGCs should assess VfM in [CP19/15](#)
 - proposals to specify a simple framework for the annual IGC VfM assessment process, including a definition of VfM and 3 key elements of value
 - a requirement for the IGC to assess whether its pension provider offers VfM compared with other options on the market and consider whether comparable schemes offer lower administration charges and transaction costs
 - a discussion section on whether we should impose a specific obligation on pension providers to provide VfM
- 1.5** The proposals in this CP stem from our commitments in the FCA and The Pensions Regulator (TPR) joint [regulatory strategy](#) for regulating pensions and the retirement income sector. One aim of our strategy is to promote a consistent approach to assessing VfM across the pensions industry. We also want to avoid firms or IGCs undertaking work which adds little consumer value, but which adds to costs that are ultimately borne by the consumer.
- 1.6** We also plan to publish a Discussion Paper (DP) in partnership with TPR. This DP will review possible options for metrics to measure VfM and for benchmarking VfM in pensions.

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

Who this applies to

- 1.7** This consultation affects those who are involved in FCA-regulated pension schemes within the defined contribution (DC) workplace pensions market. This includes:
- IGCs and GAAs, and their advisers
 - all firms that intend to provide pathway solutions and that provide FCA regulated workplace pension products
 - third party firms that provide GAAs
 - workplace pension scheme members and their employers
 - consumer representative groups
 - trade bodies representing financial services firms
 - charities and other organisations with a particular interest in the ageing population and financial services

The wider context of this consultation

- 1.8** The Office of Fair Trading's (OFT) 2013 [market study](#) into defined contribution (DC) workplace pensions concluded that competition alone would not drive VfM for DC savers. Consumers with workplace personal pensions are likely to have limited engagement with their workplace pension while some employers may lack the capability or incentive to ensure their employees receive VfM. In response, the FCA, the Department of Work and Pensions (DWP) and TPR worked closely to design a package of measures to address the risks of consumer harm.
- 1.9** 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 VfM of these schemes.
- 1.10** In October 2018, we and TPR published our joint regulatory strategy (the 'strategy') for regulating the pensions and retirement income sector. The strategy identified 2 new priority areas for joint action. One of these was using our powers to help drive VfM for pension scheme members – including setting and enforcing clear standards and principles where relevant.
- 1.11** In December 2019, we published [PS19/30](#) which set out rules to extend the remit of IGCs. This included new duties for IGCs to:
- consider and report on their firm's policies on environmental, social and governance (ESG) issues, member concerns, and stewardship, for all products that IGCs oversee, and
 - oversee the VfM of investment pathway solutions for pension drawdown (pathway solutions)
- 1.12** In February 2020, we published [PS20/2](#). This set out rules that require scheme governance bodies to report costs and charges information.
- 1.13** We are also publishing [TR20/1](#) alongside this CP. [TR20/1](#) reviews the effectiveness of IGCs and GAAs in improving the VfM of workplace pensions for customers. The findings of [TR20/1](#) have informed the proposals within this CP.

What we want to change

- 1.14** To clarify our expectations and promote a consistent approach to assessing VfM, we propose to introduce new requirements on providers to ensure their IGCs:
- Take into account 3 key elements of value: charges and costs; investment performance; and services provided (including member communications).
 - Assess and report on VfM, in particular through comparison with some reasonably comparable options on the market, or if available in the future relevant benchmarks (as this will only apply if they are available in the future, this is not set out in our proposed requirements).
 - As far as they are able, to consider whether an alternative scheme would offer lower administration charges and transaction costs and inform the pension provider if so. If the IGC is unsatisfied with the pension provider's response, the IGC should also inform the relevant employer.
 - Set out their overall assessment in their reports about whether the scheme or pathway investment provides value for money.
 - Explain how they have assessed VfM in their reports and keep relevant evidence they relied upon for at least 6 years.
- 1.15** As part of our wider strategy on VfM, we are also inviting views on whether pension providers themselves should have a direct responsibility for VfM, alongside the IGC.

Measuring success

- 1.16** Our proposals are intended to establish greater consistency in how IGCs assess VfM, promote transparency and enable clearer comparison across different products.
- 1.17** Our proposals will be successful if they lead to improvements in the VfM offered by providers. If it is easier to compare the VfM that firms offer, it will be easier to identify the lowest performers. This should encourage competition in the market and drive better VfM for scheme members.

Commencement of our proposals

- 1.18** Subject to the outcome of the consultation process, we propose that the rules and guidance should come into effect 6 months after the 1st of the month following the date on which the final instrument is made by our Board.

Next steps

What you need to do

- 1.19** 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 24 September 2020.

How to respond to this consultation

1.20 Use the online response form on our website or, email us at CP20-09@fca.org.uk.

What we'll do next

1.21 We will consider the feedback we receive on this CP and publish our finalised Handbook text in a Policy Statement in Q4 2020.

2 The wider context

The regulators in the pensions sector

- 2.1** The Government sets the overall framework for pensions. It does this through HM Treasury (HMT) and the Department for Work and Pensions (DWP).
- 2.2** Broadly the FCA is responsible for regulating the areas of the pension savings and retirement income sector where individuals access pensions directly. TPR is responsible for regulating the areas where individuals access pensions via their employers. The FCA also has significant regulatory responsibilities for firms that provide products and services for pensions that are regulated by TPR, eg advice and asset management.

Financial Conduct Authority

- 2.3** We regulate the providers of personal pensions, stakeholder pensions, self-invested personal pensions (SIPPs) and workplace (group) personal pensions. We also regulate advice in the pensions market, and set the rules for contract-based pensions.
- 2.4** We also have broad responsibilities for regulating asset managers and other investment service firms. This includes firms providing investment services to occupational pension schemes, except where they provide advice on asset allocation or investment strategy.

The Pensions Regulator

- 2.5** TPR regulates the trustees of occupational pension schemes – both defined benefit (DB) and defined contribution (DC) schemes. TPR oversees the governance and administration of public service schemes. It is also responsible for implementing Automatic Enrolment (AE) and ensuring employers comply with their AE responsibilities. It achieves its objectives through exercising the functions set out in pensions legislation, and setting standards via codes and guidance.
- 2.6** The Pension Schemes Act 2017 gave TPR new powers to authorise and supervise master trusts.

The harm we are trying to address

- 2.7** In January 2013, the Office of Fair Trading (OFT) launched a market study into the market for DC workplace pensions. This examined whether, under AE, competition could drive VfM and good outcomes for scheme members.
- 2.8** The OFT's final report concluded that competition alone could not drive VfM for DC savers. This was due to 2 combined factors:

- Weakness on the buyer side of the market – scheme members rely on their employers to make most of the key decisions about their pensions for them. But many employers lack the capability and/or the incentive to ensure that members of their schemes get VfM in the long term.
- The complexity of the product – DC workplace pension schemes are complicated products. It is difficult to assess their costs and quality, and outcomes may not be seen for some years.

2.9 The OFT made recommendations to improve the governance of DC workplace schemes, improve the quality of available information about schemes and address current and future risks of consumer harm.

2.10 In light of these recommendations, and our statutory objectives, we have been working with DWP and The Pensions Regulator (TPR) to design and implement a package of reform measures. These aim to help ensure that all workplace pension schemes are of high quality and offer VfM, reducing the risk of consumer harm.

2.11 In 2016, TPR set out in its DC code its regulatory expectations of trustees of DC occupational schemes when they assessed value for members (as required under pensions legislation). The DC code is supplemented by a Guide to Value for Members which was also published in 2016 and updated in 2019. The Guide provides specific guidance to trustees on assessing value for members. Together, these documents provide a non-mandatory framework which includes a definition of VfM, a list of the factors that trustees could consider and a high-level process for conducting the VfM assessment.

2.12 Further measures on VfM in workplace pension schemes that we have implemented to date include:

- a charge cap on default funds in automatic enrolment schemes and banning of certain charging practices
- measures to improve how asset managers disclose costs and charges to scheme governance bodies
- a new duty on IGCs to oversee the VfM of investment pathway solutions for pension drawdown
- requiring scheme governance bodies to publish and disclose information about administration charges and transaction costs – ‘costs and charges information’ – to members of workplace pension schemes

2.13 We are also publishing TR20/1 alongside this CP. TR20/1 reviews the effectiveness of IGCs and GAAs in improving the VfM of workplace pensions for customers. The review evidence suggested some IGCs have more robust arrangements than others in providing independent challenge to pension providers, and some weakness in the practices of GAAs. The findings of TR20/1 have informed our proposals within this consultation paper, which we think could play a part in levelling up some IGC practices.

2.14 This CP contains proposals on the annual IGC VfM assessment process. This includes 3 elements that IGCs must take into account in answering whether their pension provider offers VfM compared with other options on the market. Our proposals aim to address the harm that some consumers may be in pension schemes which do not deliver VfM.

How it links to our objectives

Consumer protection

- 2.15** Improving the assessment of VfM of workplace pension schemes is intended to increase pressure on providers to offer value. Clarifying our expectations may also avoid firms or IGCs undertaking work which adds little consumer value, but does add costs ultimately borne by the consumer.

Competition

- 2.16** Our proposals are designed to ensure that employers, scheme members and employee representatives (eg trade unions) can access better information about VfM, promoting more effective competition between firms in the interests of consumers.

Wider effects of this consultation

- 2.17** The proposals set out in this CP are part of a package of reform measures to help ensure that all DC workplace pension schemes are high quality and offer VfM. In particular, our proposals may have direct relevance to the ideas we plan to raise in our DP on VfM metrics to be published together with The Pensions Regulator (TPR).

Equality and diversity considerations

- 2.18** We have considered the equality and diversity issues that may arise from our proposals.
- 2.19** Overall, we do not consider that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals in light of the feedback we receive during the consultation period, and will revisit them when making the final rules.

3 Feedback from CP19/15

- 3.1** In this chapter, we summarise the feedback we received to 2 questions in our 2019 consultation on extending the remit of IGCs ([CP19/15](#)). We sought views on whether there is a case for more prescriptive rules and guidance on how VfM is assessed, and the comparison of legacy products. We are grateful to all those who took time to provide their views.

More prescriptive rules and guidance on value for money

- 3.2** In [CP19/15](#) we explained that we are working with TPR to develop a shared view of what good looks like in workplace pension schemes and how IGCs should assess VfM. We suggested this may lead to more prescriptive rules and guidance on VfM for firms and IGCs.

Feedback received

- 3.3** We received responses from a range of organisations including trade associations, providers, IGCs and charities.
- 3.4** Most respondents agreed with our suggested approach. Of these, some thought that further rules and guidance would clarify our expectations and encourage a consistent approach to assessing VfM. Others cautioned that while more detailed guidance would be useful, too much prescription would limit the IGC's ability to tailor its approach to their provider's scheme and customer base.
- 3.5** A few respondents disagreed with the suggested approach, with one advocating a more principles-based approach.

Our Response

- 3.6** We have used feedback received to inform our proposals for a new framework for IGCs to assess VfM. We set these proposals out in Chapter 4. We propose a common definition of VfM as Handbook guidance and 3 elements of value. But we have kept the framework simple and high level.

Comparing legacy pension products

- 3.7** In [CP19/15](#) we also invited views on what legacy pension products should be compared with when assessing VfM.
- 3.8** We recognised that what counts as VfM may change over time. Charges may reduce and quality increase, because of innovation and technological change, competition,

and changes to regulatory requirements. This means that a pension product that was considered VfM when it was sold may no longer be so.

- 3.9** This raises difficult issues. A consumer might be in a contract that no longer appears to be VfM. But the provider may have been counting on a continuing 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.
- 3.10** This is relevant to how the market competitiveness of legacy pension products can be assessed. Should the basis of comparison be other legacy products, eg similar legacy products? Or should it be relative to newer products in the market today?

Feedback received

- 3.11** Over half of respondents thought that, when assessing VfM, legacy products should be compared with products on the market today. Most of these thought that IGCs should pressure firms to improve the value of legacy products to the same level as that offered by more recent or current products. The particular benefits of legacy products should be factored into this assessment, or explained in the text of the report.
- 3.12** Some also said that there is no evidence that consumers are 'locked in' to a product. If the IGC decides that a legacy product no longer provides VfM and it is not possible to improve these products, respondents thought that the IGC should contact customers to consider alternatives.
- 3.13** Other respondents thought that the basis of comparison should be with other similar legacy products. They emphasised that a 'one size fits all' approach was not appropriate. This is because legacy products contain valuable features, such as guaranteed annuity rates, which do not exist in most new products. They further highlighted the complexity of comparing different charging structures. They also said the increased expense for providers of running legacy schemes was a reason for a higher cost to the consumer.
- 3.14** Some of these respondents suggested that current guidance in [FG16/8](#) on the treatment of longstanding customers gives sufficient clarification of our expectations of VfM on legacy products. One respondent also thought that a provider's executive customer or fairness committee is better placed to conduct a comparison than the IGC, as they have a greater understanding of legacy features and funds' operation.
- 3.15** A few respondents thought it was not possible to compare legacy products at all.

Our Response

- 3.16** Firms should treat longstanding customers fairly. Our [Business Plan](#) identifies the fair treatment of existing customers as a cross-sector priority. The feedback we received, combined with the wider priority we have given to fair treatment of 'back book' customers has informed the clarification of our existing rules on legacy products set out in Chapter 4.

4 Assessing value for money – for consultation

Background to IGC value for money assessment

- 4.1** Providers of workplace personal pension schemes and pathway solutions are required to establish an IGC to provide independent oversight of VfM. IGCs must act independently and solely on behalf of scheme members or pathway investors (as applicable) in assessing VfM.
- 4.2** The rules regarding IGC oversight of pathway solutions came into effect on 6 April this year, but rules for providing pathway investments will come into effect on 1 February 2021. So, a number of the requirements covered below are subject to transitional provisions.
- 4.3** Our existing rules require providers to ensure that their IGCs assess the ongoing VfM for scheme members or pathway investors (as applicable). This must include an assessment of:
- whether the default investment strategies or pathway solutions are designed and undertaken in the interests of scheme members or pathway investors, and have clear statements of aims and objectives
 - whether the firm regularly reviews the characteristics and net performance of investment strategies or pathway solutions to ensure they align with the interests of scheme members or pathway investors and that the firm takes action to make any necessary changes
 - whether core financial transactions are processed promptly and accurately
 - the level of charges scheme members or pathway investors pay
 - the direct and indirect costs incurred as a result of managing and investing, and activities from managing and investing, the pension savings of relevant scheme members, or, the drawdown fund of pathway investors, including transaction costs
- 4.4** Each year, providers must publish on their website the IGC's assessment. These reports include the IGC's opinion on the VfM of the provider's workplace personal pensions or pathway solutions (as applicable) and how the IGC has considered the interests of scheme members or pathway investors.
- 4.5** Our existing guidance states that IGCs should raise any concerns directly with the governing bodies of providers (typically the Board) and providers must respond to these concerns. An IGC may escalate its concerns to us, where it considers that the firm has not satisfactorily addressed its concerns, may alert relevant scheme members or pathway investors and employers, and may make its concerns public.

A new framework for IGCs to assess value for money

- 4.6** Since IGCs were introduced, there has been a growing demand for us to be clearer about our expectations for how VfM should be assessed. TR20/1 also found a lack of consistency in the structure of IGC reports, with some displaying insufficient rigour or reviewing areas that are of little consumer benefit. .
- 4.7** TPR sets out in their DC code their regulatory expectations of trustees of DC occupational pension schemes when carrying out a value for members assessment. As well as the code, it gives specific guidance on assessing value for members. This provides a (non-mandatory) framework which includes a definition of value for members, a list of the factors that trustees could consider, and a high-level process for conducting the value for members assessment.
- 4.8** In this CP, we propose to introduce a common definition of VfM and 3 elements that IGCs must take into account in a VfM assessment. This would be supplemented by further Handbook guidance about our expectations. This is designed to promote a consistent approach with TPR for assessing VfM. Our proposals would apply to IGCs' VfM assessment of investment pathways as well as DC workplace pensions in accumulation.
- 4.9** Based on our discussions with IGCs the 3 key elements we think contribute to VfM in pensions are:
- charges and costs,
 - investment performance, and
 - quality of service.
- 4.10** We propose that IGCs are required to consider these elements as starting points when assessing VfM.
- 4.11** We hope that these proposals can pave the way for the use of standardised metrics and/or benchmarks in initiatives such as the pensions dashboard or open finance. This may help at least the most engaged consumers to take greater control of their finances.

Q1: Do you agree with our 3 proposed elements for assessing value for money? If not, what alternative elements do you suggest?

Defining value for money

- 4.12** To provide a clear direction for IGCs, we propose to introduce an explicit definition of VfM. In developing a definition, our aim is to make this specific to the role of the IGC and to align it with TPR's DC code. This definition would be set out as guidance in our handbook.
- 4.13** We think it is difficult to conduct a meaningful assessment of VfM when an individual provider's schemes are reviewed in isolation. A review of other options available on the market can provide a point of reference, and may provide better value for scheme members. But this review of other options should not form the sole basis of an assessment.

4.14 So, we propose new guidance to define VfM in the context of the IGC assessment process:

The administration charges and transaction costs borne by relevant policyholders or pathway investors are likely to represent value for money where the combination of the charges and costs and the investment performance and services are appropriate

- a. for the *relevant policyholders* or pathway investors; and
- b. when compared with other comparable options on the market.

4.15 The scope of this comparison would be a matter for the IGC. For workplace pension schemes, this could include not-for-profit options such as NEST or The People's Pension.

4.16 We do not expect IGCs to have the time, resources or expertise to compare all other options on the market. This would not be cost effective. In practice, we expect an IGC to pick a small number of reasonably comparable schemes or investment pathways including those that could potentially offer better value for money (against the factors set out in the rules), to conduct their assessment. When selecting comparable schemes, we expect the IGC to take into account the size and demographics of the membership.

4.17 This comparison with other comparable options on the market applies to the extent that information about those options is publicly available.

4.18 In relation to schemes only, we propose that firms require their IGCs to state in the annual report the reasons why the comparable schemes selected provide a reasonable comparison. In future, we would like to see the emergence of suitable benchmarks to make a reasonable comparison easier.

Q2: Do you agree with our proposed definition of VfM? If not, what alternative wording would you suggest?

Q3: Do you agree with our proposed process for VfM assessment? If not, what alternative process would you suggest?

Charges and transaction costs

4.19 In 2012, the Government introduced automatic enrolment for workplace pensions. Default funds were created for those who had auto-enrolled and not actively made a fund choice. Since 2015, there has been a charge cap for those default funds. DWP created regulations to introduce the charge cap and we created equivalent rules for the pension products that we regulate. The charge cap limits the charges for a default fund to 0.75% of funds under management per year (excluding transaction costs).

4.20 We expect IGCs to challenge their pension provider on the level of costs and charges to scheme members and pathway investors.

4.21 We propose that for workplace pension schemes firms require their IGCs to consider whether any of the comparable schemes assessed in the VfM assessment process offer lower administration charges and transaction costs. This should drive competitive pressure on costs and charges of workplace pension schemes. We are confident that IGCs will have access to such pension scheme data to conduct this

comparison once scheme governance bodies begin publishing costs and charges information on their websites following our new rules in [PS20/02](#).

4.22 We also propose new guidance that as part of this comparison, if any scheme offers lower administration charges and transaction costs, the IGC should bring this matter, together with an explanation and relevant evidence to the attention of the firm's governing body and, if the IGC is not satisfied with the response of the firm's governing body, inform the relevant employer directly.

Q4: Do you agree with our proposals for IGCs to compare charges and transaction costs with other options on the market? If not, how should IGCs review costs and charges?

4.23 Evidence from [TR20/1](#) highlights high charges among some categories of pension scheme, particular legacy schemes. We expect the IGC to go further than merely ensuring their provider has implemented the mandatory 0.75% charge cap, where this is relevant, or that the charges are under 1% in the case of legacy schemes. So, we propose guidance to clarify that a scheme that fully complies with the charge cap does not necessarily indicate VfM. For arrangements where the mandatory charge cap does not apply, we propose further guidance that reducing charges to 1% does not necessarily indicate VfM.

Q5: Do you agree with our proposed guidance that fully complying with the charge cap does not necessarily indicate value for money?

4.24 For workplace pension schemes, we expect the IGC to consider the scale of the employer and the size and demographic of the scheme membership when drawing its conclusions. Our intention is that IGCs will apply pressure to providers where administration charges and transaction costs are significantly higher than comparable options available on the market.

Q6: Do you agree that a reasonable comparison of costs and charges with other options available on the market will put pressure on high-charging providers to reduce their charges and transaction costs? If not, how else could this outcome be achieved?

Investment performance

4.25 Investment performance can have a significant impact on a scheme's value and so is an important part of the provider's overall VfM. We expect the IGC to include analysis of investment performance in its annual report. This could include:

- investment returns delivered and expected, net of fees
- investment risk profile – tailored to the needs of members, and monitored and maintained within acceptable limits
- investment objectives and strategies aligned to retirement options and choices

4.26 Currently, an IGC's terms of reference must require it to assess whether default investment strategies or pathway solutions are designed and executed in the interests of scheme members or pathway investors (COBS 19.5.5R(2)(a)(i) and COBS 19.5.5R(2A)(a)(i)), and whether the characteristics and net performance of a scheme's investment strategies or a pathway solution are regularly reviewed by the firm to ensure alignment with the interests of scheme members or pathway investors and that the firm takes action to make any necessary changes (COBS 19.5.5R(2)(b) and COBS 19.5.5R(2A)(b)).

4.27 So, under our existing rules we expect IGCs to include all default arrangements in their assessment. This includes those designed by employee benefit consultants and financial advisers for employers.

4.28 Under our existing rules IGCs are required to set out in their annual reports any concerns raised by the IGC and the firm's response arising from its review of the characteristics and net performance of a scheme's investment strategies or of a pathway solution. This may include any actions taken by the firm in response to the concerns raised. If the IGC concludes that the actions taken by the firm are not sufficient, this should also be reported in the annual report.

Customer Service

4.29 We consider that the services provided, which include scheme administration and communication with scheme members, are an important part of the provider's VfM offering. We expect the IGC to include analysis of services in its annual report. This could include:

- customer-facing administrative processes such as the time taken to transfer funds from one scheme to another, change customer investments or service death benefits
- the range of communication channels used
- online tools available to scheme members
- general guidance and support

4.30 For both workplace pension schemes and pathway solutions, under our existing rules IGCs must assess whether core financial transactions are processed promptly and accurately. If the IGC concludes core financial transactions are not processed promptly and accurately, we expect this to be reported in the annual report.

Legacy products

4.31 TR20/1 indicates that many IGCs are not paying sufficient attention to legacy products in their assessment process. Under our existing rules, an assessment of legacy products must include both automatic enrolment products and default funds that are not included in automatic enrolment. We expect this assessment to look beyond the cost to the firm and review value in the context of the wider market.

Q7: Do you think that further guidance will improve the assessment of legacy products?

Additional requirements for the assessment process

4.32 Evidence from TR20/01 indicates that some IGC reports did not present the overall findings of their assessment clearly, or explain how they reached them. So, we propose that IGCs should state in their assessment whether they believe that a product provides VfM or not. We also propose that IGCs must explain how they have conducted their VfM assessment and how they have arrived at their conclusions. We expect this explanation to include the VfM assessment of the firm's legacy products. The IGC must retain any evidence used in the assessment process for 6 years. .

Q8: Do you think that our proposed rules and guidance will improve the clarity of IGC annual reports?

5 Value for money responsibility for providers – for discussion

- 5.1** The SM&CR came into force for banking firms in March 2016 and was extended to insurers in December 2018. It was 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 working for regulated firms more accountable for their conduct and competence.
- 5.2** We have considered the role of IGCs relative to those of a firm's executive Board under the SM&CR. IGCs are not intended to undermine, reduce or replace the responsibilities of the firm or its employees. IGCs can provide a check and challenge from a Committee that does not also have the objective of producing profit for the firm.
- 5.3** So, we are considering whether pension providers should have a direct responsibility for providing VfM to customers, alongside the IGC. We could set a regulatory expectation that providers offer VfM, based on key factors such as costs and charges, investment performance and service. Under this approach, VfM would not be made a 'prescribed responsibility' under SM&CR, but the provider would need to delegate this responsibility to an individual within the firm.
- 5.4** We note that providers already have a responsibility under our principles to ensure the fair treatment of customers.

Q9: Do you think that firms providing pension products should have a specific responsibility on ensuring the VfM to customers of these products?

Annex 1

Questions in this paper

For consultation

- Q1:** Do you agree with our 3 proposed elements for assessing value for money? If not, what alternative factors do you suggest?
- Q2:** Do you agree with our proposed Handbook guidance about the meaning of value for money? If not, what alternative wording would you suggest?
- Q3:** Do you agree with our proposed process for VfM assessment? If not, what alternative process would you suggest?
- Q4:** Do you agree with our proposals for IGCs to consider whether any of the comparable schemes assessed offer lower administration charges and transaction costs? If not, how should IGCs review costs and charges?
- Q5:** Do you agree with our proposed guidance that fully complying with the charge cap does not necessarily indicate value for money?
- Q6:** Do you agree that a reasonable comparison of costs and charges with other options available on the market will put pressure on high-charging providers to reduce their charges and transaction costs? If not, how else could this outcome be achieved?
- Q7:** Do you think that further guidance will improve the assessment of legacy products?
- Q8:** Do you think that our proposed rules and guidance will improve the clarity of IGC annual reports?

For discussion

- Q9:** Do you think that firms providing pension products should have a specific responsibility on ensuring the VfM to customers of these products?

For consultation

- Q10:** Do you agree with the 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 and the best way to promote competition in the markets in the interests of consumers, taking into account all the other impacts we foresee.

Problem and rationale for the intervention

3. The need for regulatory interventions in the pensions products market arise from a combination of market failures – information asymmetries, misalignment of incentives, barriers to switching and behavioural biases.²

Information asymmetries and misalignment of incentives

4. Pensions products are often very complex, meaning that consumers struggle to access and understand information about their pension. This makes any decision making about the value for money of their pension difficult for consumers. This lack of understanding also means that consumers have limited ability to exert pressure on their employers or providers regarding value for money.
5. Employers often lack the capability to challenge providers for the same reasons. There is also a lack of incentive on the employers' side to ensure that their employees receive value for money in the long term. In DC pension schemes, employers are not liable for the final income that schemes provide for their employees, and employee turnover means that employers are further distanced from any long-term pressure to make sure their chosen pension scheme provides value for money.
6. The combination of the complexity of pensions products and the misalignment of incentives for employers means that the demand side of the market for workplace

2 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.

pension schemes is weak. There is limited incentive for firms to ensure that their products provide value for money for their members.

Barriers to switching

7. The lack of understanding of pensions among consumers creates a barrier to switching pension provider. However, the structure of workplace pension schemes also makes it difficult for employees to switch scheme. It is only employers who can decide to switch the scheme their employees are in. If an employee is unhappy with their workplace pension scheme, they have little option other than to continue to make contributions to the scheme, opt out and keep their pension saving in the scheme or opt out and transfer their pension saving to a new scheme. Opting out of an employer's workplace pension scheme can mean an employee will lose out on their employer's pension contribution.
8. It can be a little easier for a deferred member of a DC scheme to transfer out of a workplace pension scheme as it would not result in a loss of an employer's pension contribution (because a deferred member will no longer be receiving an employer's contribution). Similarly, pathway investors would not lose out on employer contributions as they are already entering decumulation.³ Pathway investors also have more direct control over the pathway solution that they choose and can decide themselves to switch to another provider. Nonetheless they still face the barriers to switching schemes created by lack of information.
9. These barriers to switching schemes mean that people often stay in the same schemes for a long time. Products which may have been good value for money on joining may become poor value for money over time.

The role of IGCs/GAAs in overcoming behavioural bias

10. Behavioural biases also limit the ability of consumers to assess value for money. Consumers tend to focus on shorter term needs and this can affect their understanding of how well they need their pensions products to perform. Loss aversion bias also means that consumers may give too much weight to a relatively short period of poor performance from their pension fund compared with longer periods of good performance.
11. IGCs and GAAs are designed to take on the role of challenging the firm on behalf of the consumer. They have the expertise to act on behalf of the consumer in assessing value for money. They are better placed than consumers to access and understand information and use it to assess value for money. Effective challenge and oversight from IGCs/GAAs should push providers to offer value for money. They can also help consumers understand their pensions products.

³ 'Pathway investor' means a retail client who is investing in a firm's pathway solution.

Extension of remit feedback

12. As part of our consultation for [CP19/15](#) we asked whether we should provide further guidance to IGCs on the assessment of value for money.
13. In their feedback, IGCs requested further guidance on what value for money means and how they should be assessing it. The proposed rules and guidance will provide the clarification they seek, enabling them to do their work more effectively.

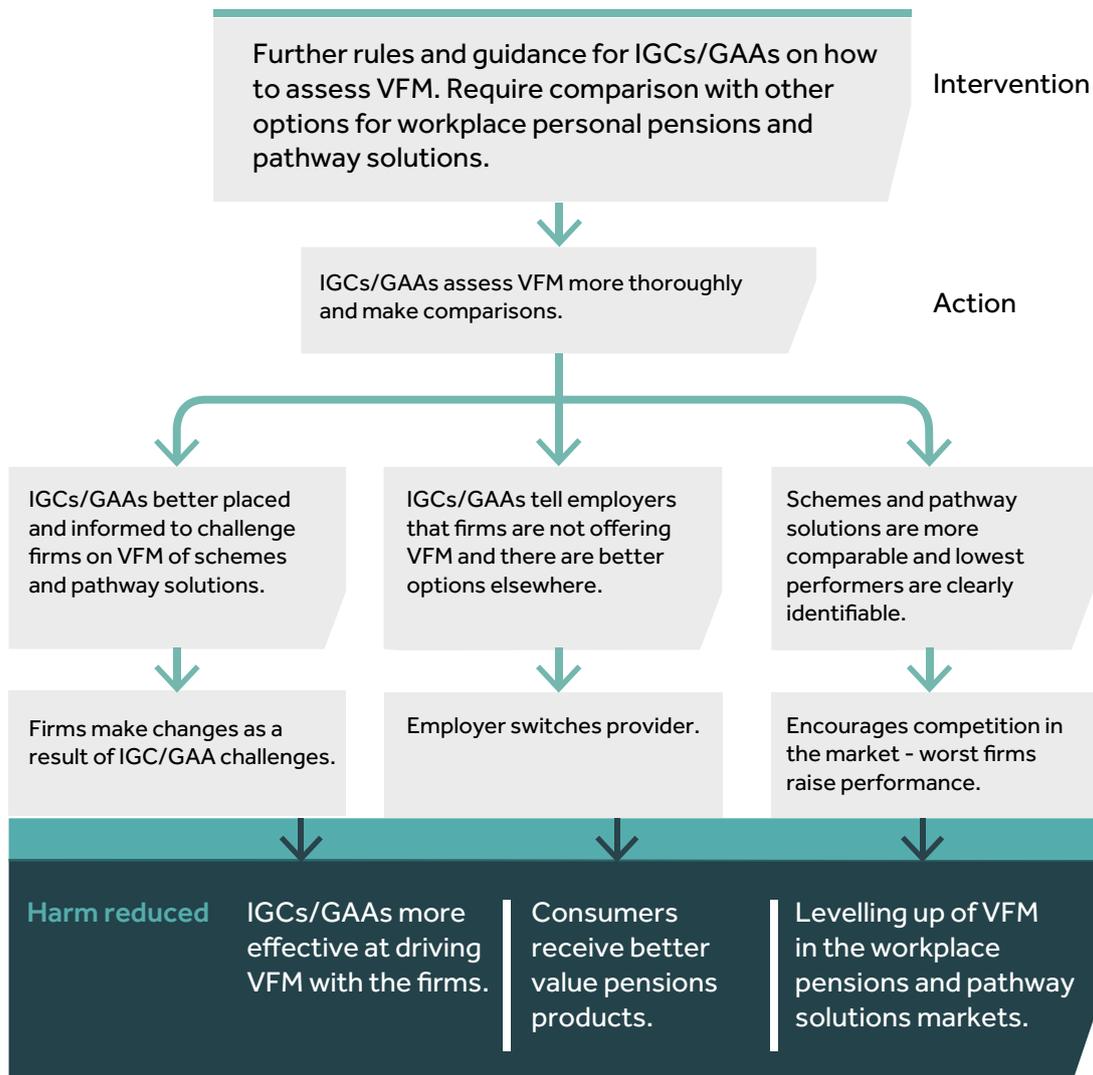
Baseline

14. Our baseline for this analysis is our current rules and what firms are doing to comply with these rules. Our [rules](#) currently require that firms procure that their IGCs/GAAs assess the value for money that the firm provides. Our rules do not specify how IGCs/GAAs should assess value for money or the factors that they should consider when doing so. Consequently, IGCs/GAAs are already completing value for money assessments but the content of the assessments is inconsistent. This means it is difficult to compare the value of different firms' schemes against each other.

Summary of proposed intervention

15. The proposed interventions aim to reduce the potential for consumer harm arising from poor value for money in the pensions products market. We require firms to procure that their IGCs/GAAs help address market failures by acting on behalf of consumers in assessing the value for money their firms' pension products offer and our proposed rules are intended to help them do so more effectively.
16. We propose to introduce rules and further guidance for firms regarding how IGCs/GAAs assess value for money. These include Handbook guidance about the meaning of value for money and the areas that IGCs/GAAs must consider when assessing it. They also include a requirement for IGCs/GAAs to compare the pensions products of their firms with other relevant options on the market. We propose guidance on the ways an IGC or GAA could conduct their value for money assessment.
17. Our proposals are to introduce new requirements on firms to procure that their IGCs/GAAs:
 - take into account three key areas: (1) charges and costs; (2) investment performance; and (3) the services provided (including member communications)
 - assess and report on VfM, in particular by reference to reasonably comparable options in the market
 - compare the administration charges and transaction costs of their firm's workplace pension schemes with other options available on the market and consider whether an alternative scheme would provide better value to policyholders and inform the pension provider if so. If the IGC is unsatisfied with the pension provider's response, the IGC should also inform the relevant employer
 - set out the overall assessment in their reports whether the scheme or pathway solution provides value for money
 - explain how they have assessed VfM in their annual reports and keep relevant evidence that they have relied upon for at least 6 years.

Figure 1: Causal chain



Key assumptions

18. We have based our cost estimates on what we know about the cost to firms of existing IGCs and GAAs and our previous cost benefit analyses that analyse the introduction of new requirements for IGCs/GAAs.
19. 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

20. Our proposals will affect all firms with workplace pension products and investment pathways solutions, all of whom are required to have either an IGC or a GAA. Our proposals extend and provide clarity for the existing duty for IGCs to assess the value for money of its firm's workplace personal pensions.

21. There are 33 firms with an IGC or GAA and all will be affected by our proposals to varying extents. There are currently 16 firms with an IGC and 17 with a GAA. We assume that all 16 firms with an IGC are larger firms and all 17 firms with a GAA are smaller firms.⁴
22. We report our cost estimates as ranges to reflect variations in the current levels of compliance.⁵

Summary of costs and benefits

23. Overall, we think that the benefits are likely to outweigh the costs. We estimate that one-off costs will be in the range of £1.5-2m and ongoing costs will be in the range of £1.7-3.0m per year. Our proposals will help IGCs assess value for money and make it much easier to compare the value for money of different pension schemes and pathway solutions. IGCs will be better placed to challenge firms on their value for money and clearer comparison will drive value for money in the market. The total ongoing costs of our proposals represent between one and two tenths of 1 basis point of total assets under management (AUM) in workplace personal pensions (£179bn).

Costs

24. We expect firms to incur one-off costs, which include familiarising themselves with the new requirements and learning costs, and ongoing costs per year, which include additional meeting time and firm costs to support the IGC/GAA.
25. Overall, across the industry, we estimate that one-off costs will be in the range of £1.5-2.0million and ongoing costs will be in the range of £1.7-3.0million per year. We explain below how we arrive at these estimated ranges.

Compliance costs to firms – one off

26. Firms will need to conduct a familiarisation and gap analysis exercise. Our estimates are based on an approximately 30-page policy paper, an approximately 8-page legal instrument and application of standard assumptions on the staff who will be involved.⁶ They are also based on our previous estimates of costs in [CP19/15](#). We estimate that the familiarisation and gap analysis costs for larger firms will be approximately £1,400 per firm and for smaller firms will be approximately £200 per firm.

4 Based on our Retirement Outcomes Review and the CBA for CP19/15, we have defined larger firms as those with over 50,000 policyholders. Smaller firms are those with fewer than 50,000 policyholders.

5 Based on a review of IGC and GAA annual reports, we estimate that over 75% of IGCs/GAAs are already taking into account charges and transaction costs, investment performance and the services provided when conducting their VfM assessments. We estimate that approximately 20% of IGCs/GAAs are undertaking some form of comparison exercise for costs and charges. This review was based on desk-based research which looked at all the IGC reports available and a selection of the GAA reports. We recognise that the depth of the analysis applied varies between firms and IGCs/GAAs and therefore the net cost of IGCs/GAAs doing this according to our guidance will vary.

6 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 0.5 hours to review the legal instrument, with hourly costs of £66/hour and £52/hour, respectively.

- 27.** We also assume learning costs in the first year as a one-off cost. These include assessing product features for the first time, for those IGCs/GAAs who have not been doing so already. Learning costs also relate to firms setting up processes to provide information and support on these areas to IGCs/GAAs. This includes the extra time and resource that will initially be required from firms in order to compare themselves against other options in the market. Given what we know about the costs incurred by firms in relation to workplace personal pensions and pathway solutions, we estimate that IGCs/GAAs will need 3 to 4 additional meetings in the first year.
- 28.** Based on our previous CBAs, we estimate that the cost to a larger firm for holding an additional IGC meeting and the work associated with it is £25,000. Therefore, we estimate that the one-off learning cost to larger firms in the first year will be between £75,000 and £100,000.
- 29.** For smaller firms, they may need to pay more for their GAA contracts, to reflect additional GAA meetings (or longer meetings) and associated work to assess areas of the firm's policies not previously considered. Based on our experience of GAAs and our previous cost benefit analyses, we estimate that this translates to a cost of approximately £5,000 for preparing for and conducting an additional GAA meeting. The additional one-off learning costs will be between £15,000 and £20,000.
- 30.** We do not expect firms to incur material system change costs, as we think the necessary systems are already in place and would require only minimal updates to reflect the new requirements.

Table 1: One-off incremental compliance costs

One-off cost	Firms with an IGC	Firms with a GAA	Total
Familiarisation and gap analysis	£1,400	£200	
Learning costs	£75,000 – £100,000	£15,000 – £20,000	
Total per firm	£76,400 – £101,400	£15,200 – £20,200	
Number of firms	16	17	33
Total one-off costs	£1,222,400	£258,400 – £343,400	£1,480,800 – £1,965,800

Compliance costs to firms – ongoing

- 31.** IGCs/GAAs who are not yet assessing the proposed areas will need additional meetings or additional time in meetings to assess the firm's policies and ensure they provide VfM compared with other options in the market.
- 32.** We estimate that on average between 2 and 3 additional IGC/GAA meetings will be needed on an ongoing basis. We assume that the average annual cost per firm for additional meetings and associated work will be in the range of £50,000 to £75,000 for firms with an IGC (based on £25,000 per meeting) and between £10,000 and £15,000 for firms with a GAA.
- 33.** There will also be additional costs to firms to provide the additional expertise and advice necessary for IGCs/GAAs to continue with the VfM assessment process. This also includes additional support costs eg more secretariat support, more need for liaison, and more senior management time. Based on our experience of firms' current practices and our estimates in [CP19/15](#), we estimate that the cost to the firm will be in

the range of £40,000 to £75,000 per year for firms with an IGC and between £7,5000 and £20,000 per year for firms with a GAA.

- 34.** As the transaction costs disclosure requirements in PS20/2 are phased in, the ongoing costs to firms for comparing the costs and charges of their workplace pension schemes against other options in the market will become minimal, as all the information required will be in the public domain. We have accounted for additional research costs in the first year in the one-off learning costs. For pathway solutions, the cost of obtaining data about pathway solutions offered by other firms will be minimal from the outset because the required information is already available in the public domain.

Table 2: On-going incremental compliance costs (per year)⁷

Ongoing cost	Firms with an IGC	Firms with a GAA	Total
Additional meetings/ time	£50,000 – £75,000	£10,000 – £15,000	
Other firm costs to support the IGC/GAA	£40,000 – £75,000	£7,500 – £20,000	
Total per firm	£90,000 – £150,000	£17,500 – £35,000	
Number of firms	16	17	33
Total ongoing costs	£1,440,000 – £2,400,000	£297,500 – £595,000	£1,737,500 – £2,995,000

Costs to the FCA

- 35.** 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

- 36.** Our proposals aim to help protect consumers with workplace personal pensions and pathway investors from potentially poor outcomes and drive value for money in the market.
- 37.** Our proposals address the risk that, against the backdrop of weak demand-side pressure, firms may not always deliver value for money.
- 38.** Our proposals are intended to help create greater consistency in how IGCs and GAAs assess value for money. This should lead to better outcomes for consumers in two ways.
- 39.** Firstly, IGCs and GAAs should be better placed and informed to challenge firms on the VfM of their schemes and pathway solutions. For example, IGCs and GAAs will have a clearer view of how the value of their firm's pathway solutions compares to other pathway solutions in the market. This means that they will be more effective in challenging firms to become more competitive in their market. This should lead to firms making changes as a result of IGC/GAA challenges. In this way, IGCs/

⁷ The estimates for on-going costs in this table are based on the estimates we made for the cost benefit analysis in [CP19/15](#).

GAAs should be more effective at driving VfM with firms and improve outcomes for consumers.

40. Secondly, for workplace pension products, our proposals should lead to IGCs/GAAs telling employers if firms are not offering VfM and there are better options elsewhere. This should lead to employers switching their workplace pension scheme to a different provider, so that their employees receive better value pensions products.
41. We expect that our proposals will help raise the quality of the poorest value for money schemes and pathway solutions in the market. If the value for money that firms offer is more easily comparable, the lowest performers will be more clearly identifiable. This should encourage competition in the market and drive better value for money for members and pathway investors.
42. Our proposals will also improve the information available to supervisors on the firms they are supervising. Our proposals will make the assessment of value for money more consistent, making the supervision of the value for money requirements for IGCs/GAAs simpler. Making supervision of the value for money requirements simpler can also contribute to better outcomes for consumers.
43. We do not think it is reasonably practical to quantify the benefits of our proposals. This is because of the difficulty of quantifying future consumer harm in the absence of our proposed value for money assessment rules.
44. 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. We expect AUM in workplace personal pensions to continue to grow in the next 10 years because of the introduction of automatic enrolment. The total ongoing costs of our proposals therefore represent between one and two tenths of 1 basis point of total AUM.⁸
45. We think the value of the benefits of our proposals is likely to exceed these costs. As laid out above, our proposals are designed to strengthen IGCs/GAAs' ability to drive value for money. For example, if our proposals helped to secure over time even just one half of a basis point reduction in fees in the workplace personal pensions market, the benefits would outweigh the costs of our proposals. More effective IGC/GAA action will also strengthen the demand side in this market, as employers may be more likely to switch provider when prompted by their IGC/GAA, leading to consumers saving money by being in better value products. A combination of a more competitive market and IGCs/GAAs being more effective in driving value for money would lead to savings for consumers. Therefore, we expect that our proposals will be of net benefit to consumers.

Q10: Do you agree with the analysis set out in our cost benefit analysis?

⁸ Ongoing costs of £3 million represent approximately 17% of one basis point of the £179 billion AUM.

Annex 3

Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of 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 certain 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 one 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 (LRRRA) the FCA is subject to requirements to have regard to a number of 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 LRRRA.

The FCA's objectives and regulatory principles: Compatibility statement

6. The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of consumer protection. Our proposals are designed to drive better value for money for consumers in the workplace personal pensions market. IGCs/GAAs should be better placed to challenge firms on behalf of consumers and reduce the harm of consumers being in poor value pensions products. This objective is also discussed in paragraph 2.9 of the main Consultation Paper.
7. They are also relevant to the FCA's competition objective. Our proposals are designed to promote competition between firms in the interests of consumers by making firms'

products more comparable and so encourage the lowest performers to raise their standards. Encouraging IGCs/GAAs to tell employers if their scheme is not offering value for money should also drive competition in the market, as employers may be more likely to switch provider.

8. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because easier for Independent Governance Committees to compare the value for money of pension products and services, enabling them to be more effective in assessing value for pension scheme members. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by s. 1F FSMA.
9. 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 economical way

10. We have considered this principle and do not believe that our proposals will have a significant impact on our resources or the way we use them.

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

11. In Annex 2, we have set out our analysis of the costs and benefits of our proposals. We believe that our proposals are a proportionate response to the duty placed upon us by the Act.

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

12. Our proposals support the government's policy objective of people saving more for their retirement and thereby relieving the tax burden on future generations.
13. Automatic enrolment is likely to drive significant growth in pension assets under management in the medium to long term, which will be available to invest in the UK economy.
14. The success of Automatic Enrolment depends on consumers being confident in saving for their pension which, in turn, depends on the ongoing value for money delivered by the pension scheme into which they invest. Our proposals aim to drive value for money and so increase consumer confidence in their pension products.

The general principle that consumers should take responsibility for their decisions

15. While we believe that consumers should take responsibility for their decisions, in this instance consumers may be automatically enrolled into the default fund of their employer's scheme without making any decision. In addition, information asymmetries and the complexity of assessing value for money may deter consumers from making choices about how their pension assets are invested.

16. Many scheme members are unlikely to be able to take decisions about how their pension assets are managed and invested. IGCs/GAAs were created to act on behalf of consumers. Our proposals aim to enable IGCs/GAAs to challenge firms on their value for money more effectively, and so drive better outcomes for consumers. Our proposals will also enable consumers who are engaged with their pension savings to be able to more easily compare their scheme against others, based on the more consistent information in the IGC/GAA annual reports.

The responsibilities of senior management

17. We have regard for 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

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

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

19. We believe that our proposals do not undermine this principle. Our proposals do not require scheme governance bodies to publish, or make publicly available, confidential or commercially sensitive information.

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

20. As part of our consultation for [CP19/15](#) we asked whether we should provide further guidance to IGCs on the assessment of value for money.
21. In their feedback, IGCs requested further guidance on what value for money means and how they should be assessing it. The proposed rules and guidance will provide the clarification they seek, enabling them to do their work more effectively. This feedback is discussed further in paragraphs 3.2 to 3.6 of the main Consultation Paper.
22. 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).
23. The intention of our value for money proposals is not to address the risk of financial crime, but we do not consider that it creates any greater risk of financial crime.

Expected effect on mutual societies

24. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

25. Our proposed rules should not impact a firm differently based on the structure of the provider.

Compatibility with the duty to promote effective competition in the interests of consumers

26. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers under section 1B(4) of the FSMA. This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives.
27. The OFT market study concluded that the buyer side of the workplace pensions market was weak with many consumers disengaged. Our proposals seek to strengthen the ability of IGCs/GAAs to act on behalf of consumers, challenging firms on how their scheme or pathway solution offer value for money compared to others. We expect that this will drive value for money in pensions and so create a more competitive market
28. Our proposals aim to make workplace personal pension schemes and pathway solutions more comparable. This will promote competition in the market, as the lowest performers will be more clearly identifiable and will seek to raise their performance.

Equality and diversity

29. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.
30. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraph 2.19 of the Consultation Paper.

Legislative and Regulatory Reform Act 2006 (LRRRA)

31. We have had regard to the principles in the LRRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that the proposals reflect these. We set out elsewhere in this annex how we consider these proposals to be transparent and proportionate.
32. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance.

- 33.** We consider that our proposals are not overly prescriptive. Our proposals aim to address an area that has been highlighted by the OFT as being a risk and in which, as the feedback to CP19/15 shows, there is appetite for further regulatory guidance.

Treasury recommendations about economic policy

- 34.** 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.

Annex 4

Abbreviations used in this paper

AE	Automatic Enrolment
CBA	Cost Benefit Analysis
CP	Consultation Paper
DP	Discussion Paper
DWP	Department for Work and Pensions
ESG	Environmental, Social and Governance
GAA	Governance Advisory Arrangement
IGC	Independent Governance Committee
OFT	The Office of Fair Trading
SIPP	Self-Invested Personal Pension
TPR	The Pensions Regulator
VfM	Value for Money



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Appendix 1

Draft Handbook text

**CONDUCT OF BUSINESS SOURCEBOOK (VALUE FOR MONEY)
INSTRUMENT 2021**

Powers exercised

- A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137T (General supplementary powers); and
 - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [6 months after the 1st of the month following the date on which the FCA Board makes the instrument].

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Conduct of Business Sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Notes

- F. In Annex A to this instrument, the notes (indicated by “*Editor’s note:*”) are included for the convenience of readers but do not form part of the legislative text.

Citation

- G. This instrument may be cited as the Conduct of Business Sourcebook (Value for Money) Instrument 2021.

By order of the Board
[date]

Annex A

Amendments to the Glossary of definitions

Amend the following definition as shown.

- administration charge* (1) (except for the purposes of COBS 19.5 and COBS 19.8), any charge made which:
- ...
- (2) (for the purposes of COBS 19.5 and COBS 19.8 only), in relation to a member of a pension scheme or (for the purposes of COBS 19.5 only) a pathway investor, means any of the following to the extent that they may be used to meet the administrative expenses of the scheme or (for the purposes of COBS 19.5 only) the *pathway investment*, to pay commission or in any other way that does not result in the provision of pension benefits for or in respect of members or (for the purposes of COBS 19.5 only) pathway investors:
- (a) any payments made to the scheme or (for the purposes of COBS 19.5 only) for a *pathway investment* by, or on behalf or in respect of, the member or (for the purposes of COBS 19.5 only) pathway investor; or
 - (b) any income or capital gain arising from the investment of such payments; or
 - (c) the value of the member's rights under the scheme or (for the purposes of COBS 19.5 only) the pathway investor's rights under the *pathway investment*;

but an administration charge does not include any charge made for costs:

- (d) incurred directly as a result of buying, selling, lending or borrowing investments; or
- (e) incurred solely in providing benefits in respect of the death of such a member or (for the purposes of COBS 19.5 only) pathway investor; or
- (f) incurred in complying with a court order, where that order has provided that the *operator*, trustee or manager of the scheme or (for the purposes of COBS 19.5 only) *pathway investment* may recover those costs; or
- (g) arising from earmarking orders or pension sharing arrangements pursuant to regulations made under section 24 or section 41 of the Welfare Reform and Pensions Act 1999.

[*Editor's note*: the above wording that is set out in paragraph (2) of the definition of “administration charge” was previously set out in the definition of “administration charges” in COBS 19.8.1R for the purposes of COBS 19.5 and COBS 19.8. We are now adding it as paragraph (2) to the main Handbook Glossary definition of “administration charge” so all consequential references to “administration charges” in COBS 19.5 and COBS 19.8, should be read as, and amended to, references to “*administration charges*”. We have also inserted references to “pathway investments” and “pathway investors” where applicable for the purposes of COBS 19.5.]

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

transaction costs (for the purposes of COBS 19.5 and COBS 19.8) means costs incurred as a result of the buying, selling, lending or borrowing of *investments*.

[*Editor's note*: the above definition of “transaction costs” was previously defined in COBS 19.8.1R for the purposes of COBS 19.5 and COBS 19.8. We are now adding it as a definition to the main Handbook Glossary so all consequential references to “transaction costs” in COBS 19.5 and COBS 19.8, should be read as, and amended to, references to “*transaction costs*”.]

Annex B

Amendments to the Conduct of Business Sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

19 Pensions supplementary provisions

...

19.5 Independent governance committees (IGCs) and publication and disclosure of costs and charges

...

Definitions

19.5.1 R In this section:
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(1A) “investment performance” means the investment performance of the:

(a) pension savings of *relevant policyholders*; or

(b) the drawdown fund of pathway investors;

...

(5A) “services” refers to the services provided by a *firm* to *relevant policyholders* or pathway investors and includes:

(a) the communications issued to *relevant policyholders* or pathway investors; and

(b) the administration of the *relevant scheme* or *pathway investment*;

...

Interpretation

19.5.1 R ~~In this section “administration charges” and “transaction costs” have the same~~
B ~~meaning as in COBS 19.8.1R. [deleted]~~

...

Terms of reference for an IGC

19.5.5 R A *firm* must include, as a minimum, the following requirements in its terms of reference for an *IGC*:

...

- (2) the *IGC* will assess the ongoing value for money for *relevant policyholders* delivered by a *relevant scheme* particularly, though not exclusively, through assessing the three factors in (a) to (c) below, taking into account the specific points in (d) to (f):
- (a) the level of charges and costs in particular:
- (i) *administration charges and any transactions costs borne by relevant policyholders; and*
- (ii) *any other charges borne by relevant policyholders and any other costs incurred as a result of managing and investing, and activities in connection with the managing and investing of, the pension savings of relevant policyholders;*
- (b) investment performance; and
- (c) the quality of services including whether:
- (i) the communications are fit for purpose and properly take into account the characteristics, needs and objectives of the *relevant policyholders*; and
- (ii) core financial transactions are processed promptly and accurately, such as processing contributions, transfers or death benefits;
- (d) as part of the assessment in (2)(a)(i), (b) and (c), the *IGC* will need to:
- (i) select a small number of reasonably comparable schemes (including those which could potentially offer better value for money in respect of factors (a)(i), (b) and (c));
- (ii) compare the *relevant scheme* against the comparable schemes based on factors (a)(i), (b) and (c) (to the extent that there is publicly available information about the comparable schemes in respect of those factors); and
- (iii) consider whether any of the comparable schemes offer lower *administration charges and transaction costs* for *relevant policyholders*;
- (e) as part of the assessment in 2(c), the *IGC* will need to assess whether default investment strategies within those schemes:
- (a) are designed and executed in the interests of *relevant policyholders*; and

- (ii) have clear statements of aims and objectives;
 - (f) as part of the assessment in 2(c), the IGC will need to assess
 - ~~(b)~~ whether the characteristics and net performance of investment strategies are regularly reviewed by the *firm* to ensure alignment with the interests of *relevant policyholders* and that the *firm* takes action to make any necessary changes;
 - ~~(e)~~ ~~whether core scheme financial transactions are processed promptly and accurately;~~
 - ~~(d)~~ ~~the levels of charges borne by *relevant policyholders*;~~
 - ~~(e)~~ ~~the direct and indirect costs incurred as a result of managing and investing, and activities in connection with the managing and investing of, the pension savings of *relevant policyholders*, including transaction costs; and~~
 - ~~(f)~~ ~~whether the communications to *relevant policyholders* are fit for purpose and properly take into account the *relevant policyholders*' characteristics, needs and objectives;~~
- (2A) the IGC will assess the ongoing value for money for pathway investors delivered by a *pathway investment* particularly, though not exclusively, through assessing the three factors in (a) to (c) below, taking into account the specific points in (d) to (f):
- (a) the level of charges and costs in particular:
 - (i) administration charges and any transactions costs borne by pathway investors; and
 - (ii) any other charges borne by pathway investors and any other costs incurred as a result of managing and investing, and activities in connection with the managing and investing of, the drawdown fund of pathway investors;
 - (b) investment performance; and
 - (c) the quality of services including whether:
 - (i) the communications are fit for purpose and properly take into account the characteristics, needs and objectives of the pathway investors; and
 - (ii) core financial transactions are processed promptly and accurately, such as processing contributions, transfers or death benefits;

- (d) as part of the assessment in (2A)(a)(i), (b) and (c), the IGC will need to:
- (i) select a small number of reasonably comparable investment pathways (including those which could potentially offer better value for money in respect of factors (a)(i), (b) and (c)); and
 - (ii) compare the investment pathway against the comparable investment pathways based on factors (a)(i), (b) and (c) (to the extent that there is publicly available information about the comparable investment pathways in respect of those factors);
- (e) as part of the assessment in (2A)(c), the IGC will need to assess whether the pathway investment offered by the firm:
- (a)
 - (i) is designed and managed in the interests of pathway investors; and
 - (ii) has a clear statement of aims and objectives;
- (f) as part of the assessment in (2A)(c), the IGC will need to assess whether the characteristics and net performance of the pathway investment are regularly reviewed by the firm to ensure alignment with the interests of pathway investors and that the firm takes action to make any necessary changes;
- ~~(b) whether core financial transactions are processed promptly and accurately;~~
- ~~(c) the levels of charges borne by pathway investors;~~
- ~~(d) 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 fund of pathway investors, including transaction costs; and~~
- ~~(e) whether the communications to pathway investors are fit for purpose and properly take into account the pathway investors' characteristics, needs and objectives;~~
- ...
- (6) the Chair of the IGC will be responsible for the production of an annual report setting out, in sufficient detail, taking into account the information needs of consumers:
- (a) the IGC's opinion on:

- (i) the value for money delivered by a *relevant scheme* or a *pathway investment*, particularly against the matters listed under (2) or (2A) and a statement setting out their overall assessment of whether the *relevant scheme* or *pathway investment* provides value for money; and
- (ii) ...
- (aa) ...
- (ab) an explanation of how the IGC carried out their assessment of ongoing value for money. This must include demonstrating how the factors set out in (2)(a) to (c) or (2A)(a) to (c) have been fully and properly considered;
- (ac) the reasons:
 - (i) for the IGC's overall assessment of whether the *relevant scheme* or *pathway investment* provides value for money as required under (6)(a)(i); and
 - (ii) (in relation to a *relevant scheme* only), why the IGC considers that the comparator schemes it selected for the purposes of its assessment under (2)(d) provided a reasonable comparison against the *relevant scheme*;
- (b) ...
- ...
- (10) ...
 - (a) ...
 - (b) persons within the application of the *relevant scheme* and qualifying or prospectively qualifying for benefits under the *relevant scheme*; ~~and~~
- (11) the IGC will ensure that information is communicated under this *rule* in a manner that pays due regard to the purposes for which *relevant policyholders* might reasonably use the information; and
- (12) the IGC will retain copies of any evidence used in their assessment of ongoing value for money for a minimum of six years.

Value for money assessment

- 19.5.5 G (1) In the context of the IGC's assessment of ongoing value for money for *relevant policyholders* or pathway investors under COBS 19.5.5R(2) or COBS 19.5.5R(2A):
- A

- (a) the administration charges and transaction costs borne by relevant policyholders or pathway investors are likely to represent value for money when the combination of the charges and costs, and the investment performance and services are appropriate:
- (i) for the relevant policyholders or pathway investors; and
- (ii) when compared to other comparable options on the market.
- (b) As part of the IGC's assessment under (1)(a)(i) regarding what is appropriate for relevant policyholders, the IGC should consider the size of the employer and the size and demographic of the membership of the relevant scheme.
- (c) The IGC should not use a firm's compliance with the limits on administration charges (COBS 19.6.6R), of itself, as evidence of value for money.
- (d) Where the limits on administration charges in COBS 19.6.6R do not apply, the IGC should not use the fact that a firm keeps its administration charges at or below 1%, of itself, as evidence of value for money.
- (3) As part of the selection of comparable schemes carried out in accordance with COBS 19.5.5R(2)(d), the IGC should take into account the size and demographic of the membership.
- (4) As part of the IGC's selection of reasonably comparable schemes or investment pathways under COBS 19.5.5R(2)(d)(i) or COBS 19.5.5R(2A)(d)(i), the IGC will need to include comparable schemes or investment pathways that potentially offer better value for money in respect of the factors set out in COBS 19.5.5R(2)(a)(i), (b) and (c) or COBS 19.5.5R(2A)(a)(i), (b) and (c) (based on whatever information is publicly available and is relevant to those factors).
- (5) There is no expectation by the FCA that the IGC would carry out a comparison of all the comparable schemes or all the comparable investment pathways in accordance with COBS 19.5.5R(2)(d) or COBS 19.5.5R(2A)(d).

Interests of relevant policyholders or pathway investors and consideration of adequacy and quality of a policy

19.5.6 G ...

- (5A) In addition to the ability of the IGC to escalate a concern about value for money under (5), if the IGC finds that any alternative schemes offer lower administration charges and transaction costs than a relevant scheme, the IGC should bring this matter, together with an explanation

and relevant evidence, to the attention of the *firm's governing body* and, if the *IGC* is not satisfied with the response of the *firm's governing body*, inform the relevant employer directly.

...

19.8 Disclosure of transaction costs and administration charges in connection with workplace pension schemes

Interpretation

19.8.1 R (1) ~~'administration charges', in relation to a member of a pension scheme, means any of the following to the extent that they may be used to meet the administrative expenses of the scheme, to pay commission or in any other way that does not result in the provision of pension benefits for or in respect of members:~~

- ~~(a) any payments made to the scheme by, or on behalf or in respect of, the member; or~~
- ~~(b) any income or capital gain arising from the investment of such payments; or~~
- ~~(c) the value of the member's rights under the scheme;~~

~~but an administration charge does not include any charge made for costs:~~

- ~~(d) incurred directly as a result of buying, selling, lending or borrowing *investments*; or~~
- ~~(e) incurred solely in providing benefits in respect of the death of such a member; or~~
- ~~(f) incurred in complying with a court order, where that order has provided that the *operator*, trustee or manager of the scheme may recover those costs; or~~
- ~~(g) arising from earmarking orders or pension sharing arrangements pursuant to regulations made under section 24 or section 41 of the Welfare Reform and Pensions Act 1999.~~

[deleted]

...

(4) ~~'transaction costs' are costs incurred as a result of the buying, selling, lending or borrowing of *investments*.~~

[deleted]

