FINANCIAL CONDUCT AUTHORITY

The effectiveness of Independent Governance Committees and Governance Advisory Arrangements

Thematic Review

TR20/1

June 2020

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1 Introduction

1.1 We have reviewed the effectiveness of Independent Governance Committees (IGCs) and Governance Advisory Arrangements (GAAs) in improving value for money (VfM) of workplace pensions for customers. These governance bodies must be established by workplace personal pension providers. They have a key role to play in providing independent oversight by scrutinising the value for money of the provider's workplace personal pension schemes.

1.2 GAAs are a proportionate alternative to IGCs for firms with smaller numbers of customers and less complex products. References to IGCs throughout this publication can be assumed to also mean GAA unless we say otherwise.

1.3 Protecting the interests of workplace personal pension scheme members is a key area of focus for the FCA.

1.4 The Government introduced pension auto-enrolment in 2012. This meant that many employers who did not already provide their staff with a pension scheme were legally required to enrol eligible employees and make payments into a suitable scheme.

1.5 Members of workplace personal pension schemes are not generally able to choose which firm provides their pension scheme, and many do not make a personal decision about the investment fund(s) where pension contributions are placed. In 2015, the Office of Fair Trading (OFT) found that the market for workplace pensions suffered from a lack of competition on charges and quality, due to demand-side weaknesses and charging complexity.

1.6 To address these concerns, and as part of a package of measures introduced by the FCA, the Department for Work and Pensions (DWP), and the Pensions Regulator (TPR), IGCs were introduced. FCA rules give IGCs clear duties and strong powers to act in the interests of members and to provide credible and effective challenge on the value for money of workplace personal pension schemes.

Why did we decide to review IGCs?

1.7 The Department for Work and Pensions (DWP) and the FCA had previously assessed how trustees and firms were providing value for money for Defined Contribution workplace pension schemes. The findings were published in December 2016 and showed that, while improvements had been made for most scheme members, progress for some schemes was slow and/or inadequate to improve value for money.

1.8 Following our work with the DWP we wanted to determine the progress IGCs had made with helping firms improve value for money for scheme members. We also wanted to assess whether they had been successful in challenging firms to deliver value for money more widely for members, for both older and more recent workplace pension schemes.

1.9 In 2019 the Work and Pensions Select Committee also expressed interest in IGCs and whether they were obtaining transparent information on charges from firms and delivering value for money for workplace personal pension scheme members.

What is the potential harm to members?

High charges and poor management of pension schemes can cause harm to policyholders by reducing the level of savings that are built up. This can lead to significantly lower income in retirement and is one of the FCA's key areas of focus.

Executive summary

1.10 Our review assessed the extent to which IGCs and GAAs have been able to improve the value for money that members invested in workplace personal pension schemes receive.

1.11 We looked at the outcomes consumers had received since IGCs had been set up, including the average cost of a policy. We also considered whether IGCs were appropriately structured, resourced and had the right processes in place to effectively act in members' interests.

1.12 We saw a mixed picture. We found no systemic issues, with some IGCs having a positive impact on the outcomes members received. But we also found issues which cause concern, especially about the challenge GAAs provide, the independence of some IGCs and the ability of IGCs to obtain transaction costs.

1.13 Although it is not possible for us to link all cost reductions in policies over the period of review directly to the work of IGCs, we found that around 75% of firms in our review had made some reductions in charges for some of their workplace pensions. We estimated an average 2 basis point reduction in charges between 2017 and 2019 across all the pension savings included as part of our review. This equates to a saving of approximately £33.6m annually. We also found examples where proposed charge increases were challenged by IGCs which resulted in a change of approach by the firm.

1.14 We found a wide variation in the way IGCs operated, leading to different outcomes for members of different workplace personal schemes. All IGCs have the same key areas of responsibility but approaches to assessing value for money of individual schemes varied from one IGC to another. Where this was not effective members were more likely to receive a poor outcome.

Showing independence from firms

1.15 Some IGCs did not show sufficient independence from firms and did not effectively challenge firms in areas where members may be at risk of receiving poor value for money. We found that other IGCs were operating effectively, maintaining independence from the firms whose pension schemes they were responsible for overseeing. This was more likely to result in better outcomes for pension scheme members

1.16 GAAs are operated by a third-party firm on behalf of pension providers. While this allowed for clear independence from the pension providers, in practice, we found that although they were identifying issues, they were less effective than IGCs at delivering meaningful improvements in value for money for members.

Value for money framework

1.17 Some IGCs had a detailed framework and looked at the needs of different members when considering charges and the investment strategies in place, while others considered members collectively. Where concerns about VfM were identified, some IGCs were able to influence firms to make changes. Some, however, were unable to get firms to prioritise or put in place actions in good time and failed to escalate concerns appropriately.

Getting the right information

1.18 IGCs need information in good time for them to complete their VfM analysis. Often, they were lacking the right information to be able to do this. This was sometimes due to matters outside of a firm's direct control, but firms did not always prioritise the IGC's needs for information or resources, making it more difficult for the IGC to fulfil its role, as set out within its terms of reference. This was especially the case for transaction costs, where some firms had been unable to get some asset managers to provide information in a reasonable timescale during our review period. In our policy statement 'Transaction cost disclosure in workplace pensions' we published rules that now require asset managers to provide this information. We understand this has resulted in improvements. If firms continue to struggle to obtain this information from asset managers they should raise this with the FCA and we will consider further action to address this.

Clarity of annual reports

1.19 IGC annual reports were generally written clearly, but some lacked information on all relevant VfM matters or were written in a way unlikely to be understood by some members. Where graphs and cases studies were used, this was likely to improve understanding and make it easier for members to relate to this personally.

Planning for the future

1.20 The extent to which IGCs were forward looking and planning for future work also varied considerably. Some IGCs incorporated future priorities as key elements of their workplans, thinking in advance about their capabilities and resourcing requirements and putting clear actions in place to prepare. Others appeared to have no clear plan to prepare for work that might be on the horizon.

Next Steps

1.21 We will be providing detailed feedback to workplace personal pension providers and IGC chairs and asking for specific actions to be taken to address the failings identified. Senior managers are accountable for making sure that appropriate and timely steps are taken to deal with our concerns. We expect them to ensure that providers and IGCs work together to implement these changes.

1.22 We also expect IGCs to consider how they can improve the way that they assess and deliver value for money for workplace personal pension scheme members. Firms and IGCs should review the examples of good and poor practice contained in this report and consider what actions they need to take to ensure they can assess and deliver VfM for all relevant members. Comparison against the charges of other similar workplace personal pension schemes may help IGCs to benchmark the schemes they assess and whether these provide value for money for policyholders.

1.23 Alongside our review findings, we have published our consultation paper (CP20/9) on driving VfM in pensions. This includes:

- **a.** feedback to our questions on whether there is a need for clearer rules and guidance on how IGCs should assess value for money in CP19/15 'Independent Governance Committees: extension of remit'
- **b.** proposals to specify a simple framework for the annual IGC VfM assessment process, including a definition of VfM and 3 key elements of value
- **c.** a requirement for the IGC to consider whether its pension provider offers VfM on charges and transaction costs when compared with other options on the market
- **d.** a discussion section on whether we should impose a specific obligation on pension providers to provide value for money

1.24 For GAAs specifically we will consider whether we need to make changes to our requirements to help ensure that GAAs operate effectively, in the interests of members. We will set out any changes in due course.

2 Findings

2.1 In this chapter, we set out our findings against each of the objectives assessed and give examples of good and poor practices we saw. The good practice examples are illustrative and may describe one of a number of ways in which IGCs or firms can meet our expectations.

2.2 The examples of poor practices illustrate issues where we had cause for concern that good customer outcomes were not being achieved. Not every instance of poor practice necessarily amounts to a breach of our rules. Where we had concerns around non-compliance, we have raised those issues with the firm(s) concerned and asked the firm to take action.

2.3 We reviewed all 14 IGCs, which cover over 95% of the market by policyholders and assets under management (AUM). We reviewed a sample of 5 (out of 16) GAAs. GAAs as a whole represent approximately 1-2% of policyholders and cover 2-5% of AUM.

2.4 Due to a transfer of workplace pensions from one provider to another, 1 IGC in the sample had taken on oversight for workplace pensions from another IGC. This meant that we received information relating to the work of 15 IGCs and firms. Our focus was on the 14 IGCs that were actively overseeing workplace pensions, so that our findings could be acted on, where relevant. However, we looked at charges data for all firms to see how these had changed from 2017 onwards. This means that our IGC/GAA effectiveness review sample was 19, but our charges analysis covers 20 workplace pension providers.

2.5 Our review approach was in 2 stages:

a. We requested information from firms and their IGCs/GAAs. This was analysed to determine whether they were effective in helping to ensure VFM for consumers.
b. We visited a sample of 7 firms (5 IGCs and 2 GAAs). We asked in-depth questions to follow up the findings from the first stage of the review.

2.6 Findings within this section apply to both IGCs and GAAs but we also identified some GAA specific points, which are detailed later within this section, under Objective 6.

2.7 It is not possible to say definitively whether IGCs have contributed to a reduction in charges for workplace pension holders. IGCs might be expected to have a gradual influence on charges over time. This makes it particularly difficult to separate the effect of IGCs from other external factors that affect charges (such as market-wide trends or firm-specific investment choices), even if we had collected detailed transactional data. Further, we have no control group without an IGC to compare against firms in our sample.

2.8 For context, we estimate that across all firms in our data request, total charges for the schemes overseen by IGCs and GAAs as a percentage of funds under management fell by roughly 2 basis points between 2017 and 2019. Our request for information asked for banded charge information, so we estimated average charges by taking the midpoint of each band, and by assuming average charges in the "> 2%" band were 2.5%. In 2019, approximately 11.8m policies were in scope, with total funds under

management of approximately £168bn, and an average pot size of £14,236. A 2 basis point saving across all these funds is approximately £33.6m annually.

2.9 Out of 20 firms with schemes overseen by IGCs or GAAs from 2017 to 2019, we estimate around 15 with overall reductions in charges as a fraction of funds under management. Changes in total charges appear to have benefitted customers of firms with IGCs more than customers of firms with GAAs, although more evidence would be needed to draw any firm conclusions.

Outcome 1 – The IGC has the right structure and processes in place to allow it to assess Value for Money (VfM) effectively.

2.10 Under this objective we considered whether an IGC had a framework or structured approach to assessing VfM for policyholders and whether it could show it was acting independently of the firm when assessing VfM.

2.11 In practice, most IGCs could show independence from the firm but there were a few instances where the firm appeared to influence the IGC's decision-making, for example through drafting much of the IGC's annual report or by an overly strong firm presence in IGC meetings. Some IGCs had a detailed framework for assessing VfM, which reflected the needs of different members, for example those with small pot sizes or those nearer retirement. Others did not have a clear framework or did not appear to have considered how, or whether, outcomes for some members might be different.

Has the IGC/GAA demonstrated that it is independent?

2.12 FCA rules require an IGC to have at least 5 members with the majority being independent of the firm, including the quorum of at least 3 members where the IGC meets or makes decisions to discharge its duties. Firm employees appointed to an IGC must act solely in the interests of policyholders in their capacity as IGC members. A small number of firms chose to appoint only independent members to their IGC, without any firm employees being appointed to the IGC. GAA providers are in practice completely independent of the firm, although in a few instances firm employees were appointed as GAA committee members in addition to representatives of the GAA provider.

2.13 It is often necessary for IGCs to invite firm representatives or other parties to IGC meetings for input on specific agenda items. Most IGCs made sure that attendance for non-committee attendees was restricted to relevant agenda items allowing IGC committee members time for private discussion and consideration.

Poor practice

There were a few examples of IGCs holding meetings without a quorum consisting of a majority of independent members, in breach of FCA rules. This has the potential to lead to decisions being made that are inappropriate and not in the sole interests of policyholders.

In some cases, the numbers of firm attendees significantly out-numbered the IGC or independent members present. Although it can be beneficial to have individuals with specific expertise present, depending on the subject under discussion, this could also lead to undue influence over decisions that are made. This may especially be the case where firm representatives are senior members of staff or attend meetings regularly when they are not members of the committee.

Does the IGC/GAA have an appropriate written framework for assessing VfM?

2.14 Most IGCs had a written framework for assessing VfM. Some IGCs had a detailed framework including at least the minimum requirements set out in FCA rules, and showing how the needs of different groups of members were being assessed. For example:

a. those that had smaller pension pots, where fixed costs or charges such as exit fees had a greater impact
b. those approaching retirement and for whom investment needs might be different
c. members that may be vulnerable, such as those with dementia, poor health or that had experienced lifestyle changes

Where a framework was in place, this did not always include all the minimum requirements for VfM assessments, or failed to show what the IGC's target or benchmark was in each of these areas. In practice, this meant it was not easy to see what the IGC considered to be VfM in areas such as charges, or what it thought would be acceptable investment performance.

Good practice

One IGC had a detailed framework which made clear how VfM would be assessed. It also included some non-standard areas such as data security, the financial strength of the firm and the IGC's own governance. The framework also considered the needs of members in legacy schemes and how the needs of all members might change over time.

Poor practice

A number of IGCs assessed VfM collectively for all members, without reflecting whether VfM for distinct groups of members might be different, such as those with small pots or those close to retirement.

VfM frameworks for some IGCs were very high level, with insufficient detail to show how VfM was assessed in practice for the different VfM components, such as charges or transaction costs. As a consequence, it was unclear how the IGC had reached its conclusions about the VfM ratings it reported in its annual report to members.

Outcome 2 – The IGC assesses the key VfM components and identifies potential deficiencies for further action.

2.15 Under this objective we considered whether IGCs appropriately assessed charges borne by policyholders and the costs incurred in managing and investing their pension savings. We also looked at whether IGCs reviewed the suitability of default funds for policyholders and other aspects of the quality of the firm's schemes.

2.16 The purpose of VfM assessment by the IGC is to highlight areas where members may be receiving poor value and to drive changes that result in clear improvements. This could lead to reductions in certain charges or costs, or less visible changes such as better administration or a more appropriate range of investment funds, for example.

2.17 We found that charges vary considerably across the market. In general, older legacy policies had higher charges than those of newer schemes. This is mainly because since 6 April 2015 workplace pension schemes that are used for automatic enrolment have been subject to a charge cap. This limits default fund charges to no more than 0.75% per year of the funds under management.

2.18 We found wide variations in how IGCs assessed the level of charges and costs and whether they provided VfM. Some clearly identified the need for charges to be reduced, including those for specific members, such as those with smaller value pension pots. Others assessed VfM on a collective basis and did not show clearly why they thought that charges or transaction costs provided VfM. For default funds, not all IGCs were looking at these to see whether the investment strategy was right for all members or measuring performance using benchmarks.

Range of charges in the market

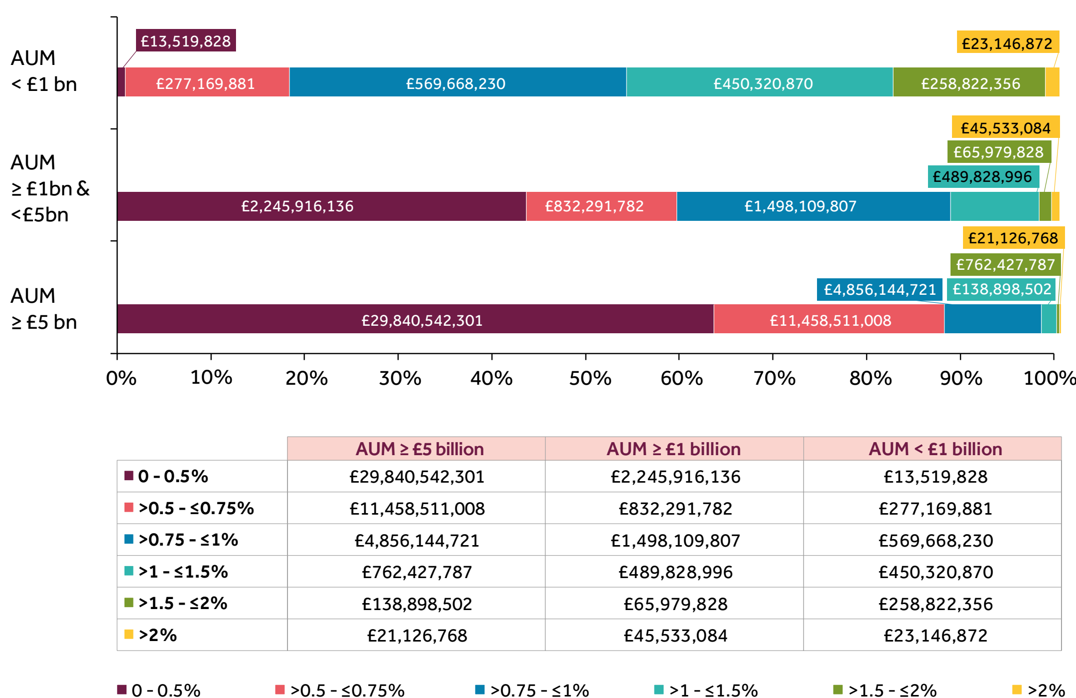
2.19 We looked at data from a sample of 20 firms. All firms were asked to provide data on charges for both legacy (pre-2001) and non-legacy (newer workplace pensions, including those used for auto-enrolment and subject to the charge cap), as at 5 April for 2017, 2018 and 2019.

2.20 Where firms in our sample had both legacy and newer workplace pensions they provided data for both. Some firms in the sample had only one type of scheme so are only represented in the charts for one of the scheme types.

2.21 Figures 1-4 group our sample of firms into small, medium and large firms based on total assets, or value of pension funds under management (AUM) the firm reported in 2019. We are not sighted as to whether the low charges represent good value or the policies with high charges represent poor value. It may be the case that policies with a high charge have a valuable guarantee which help justify a higher charge. .

Figure 1: Charges on Legacy Policies at 2017

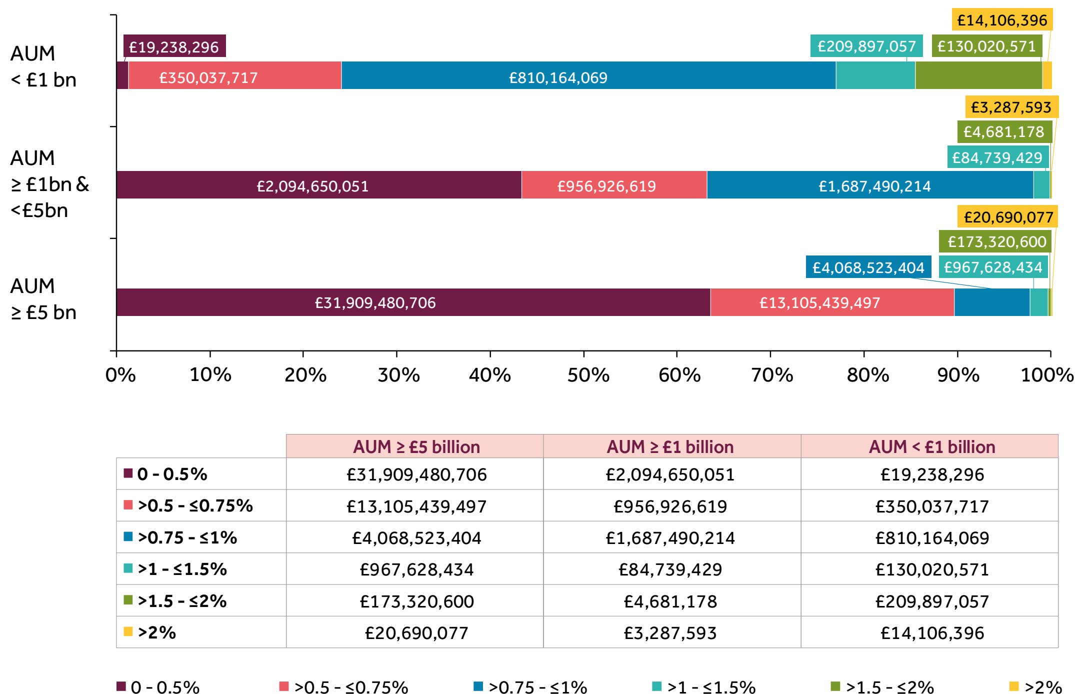
2017: Charges by firm size (in scope of IPB) by firm size



	AUM ≥ £5 billion	AUM ≥ £1 billion	AUM < £1 billion
0 - 0.5%	£29,840,542,301	£2,245,916,136	£13,519,828
>0.5 - ≤0.75%	£11,458,511,008	£832,291,782	£277,169,881
>0.75 - ≤1%	£4,856,144,721	£1,498,109,807	£569,668,230
>1 - ≤1.5%	£762,427,787	£489,828,996	£450,320,870
>1.5 - ≤2%	£138,898,502	£65,979,828	£258,822,356
>2%	£21,126,768	£45,533,084	£23,146,872

Figure 2: Charges on Legacy Policies at 2019

2019: Charges by firm size (in scope of IPB) by firm size



	AUM ≥ £5 billion	AUM ≥ £1 billion	AUM < £1 billion
0 - 0.5%	£31,909,480,706	£2,094,650,051	£19,238,296
>0.5 - ≤0.75%	£13,105,439,497	£956,926,619	£350,037,717
>0.75 - ≤1%	£4,068,523,404	£1,687,490,214	£810,164,069
>1 - ≤1.5%	£967,628,434	£84,739,429	£130,020,571
>1.5 - ≤2%	£173,320,600	£4,681,178	£209,897,057
>2%	£20,690,077	£3,287,593	£14,106,396

Source: FCA analysis of firm information request

Notes: Based on 11 firms – 4 large, 3 medium and 4 small. Two firms were not able to provide a breakdown in charges for some legacy schemes.

2.22 The charts show that overall there have been some reductions in charges for legacy schemes for firms in our sample over the period we reviewed.

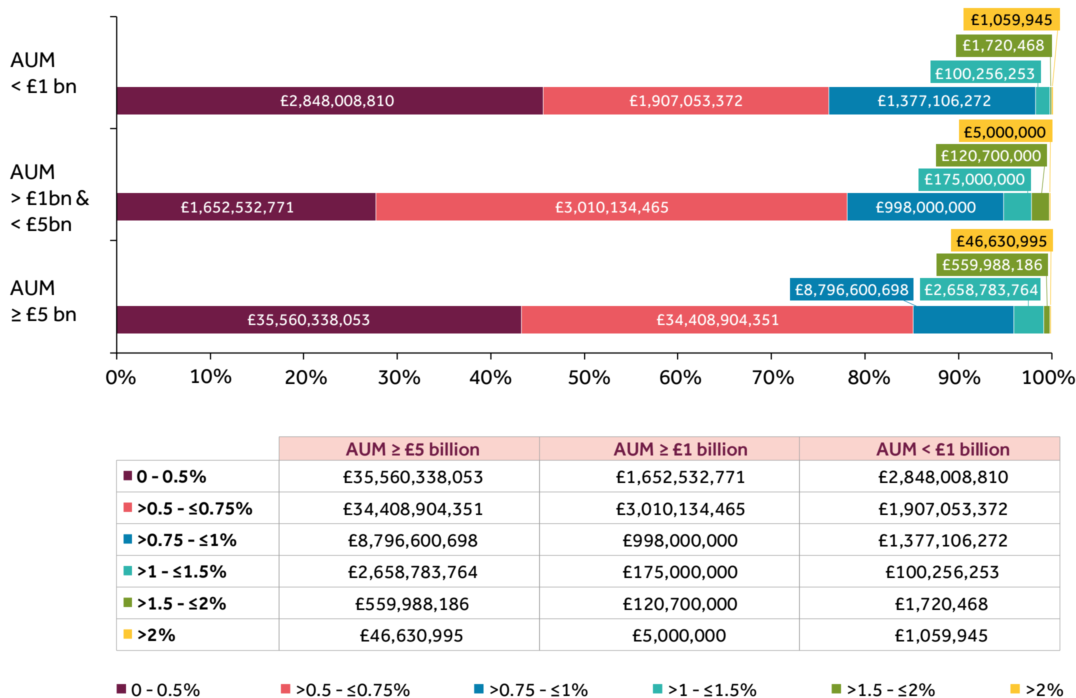
2.23 For small firms (those with relevant assets below £1bn in 2019), there has been a large decrease in pension savings subject to charges in the bands 1-1.5% and 1.5-2% between 2017 and 2019. Over the same period, there was a large increase in the proportion of pension savings invested in the 0.75-1% category, while the proportion of savings with charges below 0.75% also increased in the three years to 2019.

2.24 For medium firms (with between £1bn and £5bn relevant assets in 2019), there was a reduction in pension savings subject to charges above 1% in 2019 compared to 2017. The proportion in the 0.5%-0.75% band, and especially the 0.75%-1% band, increased between 2017 and 2019.

2.25 Assets have increased over the period for large firms in our sample by over £3bn. For these firms, there has been an increase, in absolute terms, in pensions savings subject to the lowest charge band of over £2bn, and of about £1.6bn in the 0.5%-0.75% band. The proportion of savings with the highest charges (over 2%) showed little change over the review period, but is a very small proportion of the total pension savings. Overall, a lower proportion of savings are invested in schemes with charges above 0.75% in 2019..

Figure 3: Charges on non-legacy workplace schemes at 2017

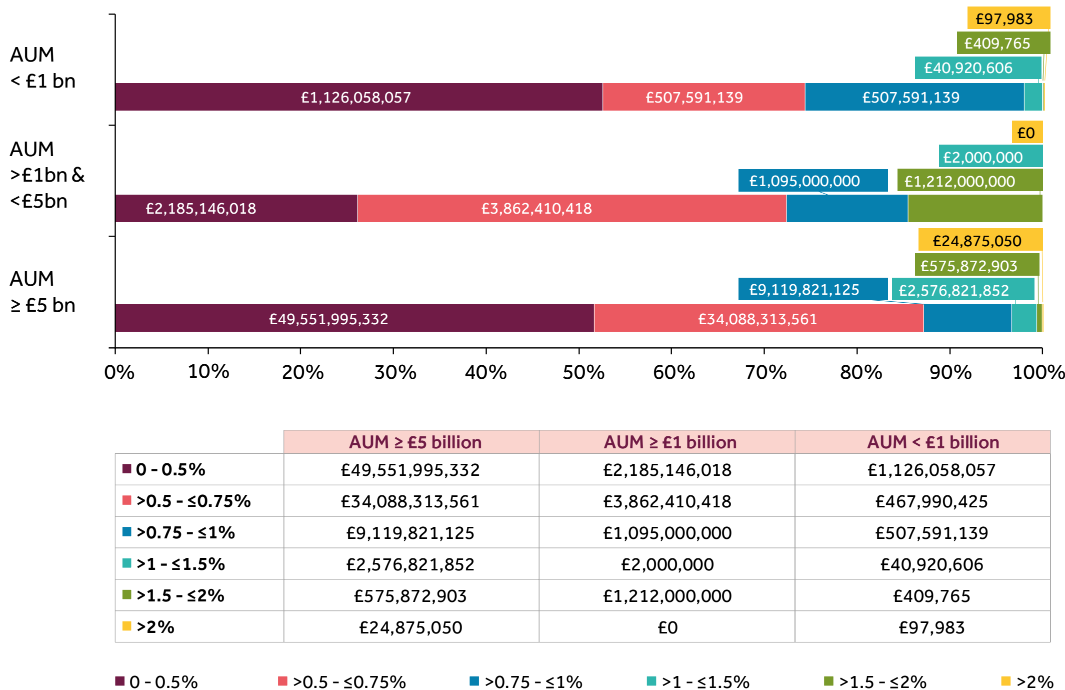
2017: Charges by firm size (in scope of IGC but not IPB) by firm size



	AUM ≥ £5 billion	AUM ≥ £1 billion	AUM < £1 billion
0 - 0.5%	£35,560,338,053	£1,652,532,771	£2,848,008,810
>0.5 - ≤0.75%	£34,408,904,351	£3,010,134,465	£1,907,053,372
>0.75 - ≤1%	£8,796,600,698	£998,000,000	£1,377,106,272
>1 - ≤1.5%	£2,658,783,764	£175,000,000	£100,256,253
>1.5 - ≤2%	£559,988,186	£120,700,000	£1,720,468
>2%	£46,630,995	£5,000,000	£1,059,945

Figure 4: Charges on non-legacy workplace schemes at 2019

2019: Charges by firm size (in scope of IGC but not IPB) by firm size



	AUM ≥ £5 billion	AUM ≥ £1 billion	AUM < £1 billion
0 - 0.5%	£49,551,995,332	£2,185,146,018	£1,126,058,057
>0.5 - ≤0.75%	£34,088,313,561	£3,862,410,418	£467,990,425
>0.75 - ≤1%	£9,119,821,125	£1,095,000,000	£507,591,139
>1 - ≤1.5%	£2,576,821,852	£2,000,000	£40,920,606
>1.5 - ≤2%	£575,872,903	£1,212,000,000	£409,765
>2%	£24,875,050	£0	£97,983

Source: FCA analysis of firm information request

Notes: Based on 17 firms – 5 large, 3 medium and 9 small. .

2.26 Figures 3 and 4 show a considerable increase over the review period in the proportion of pension savings invested in the lowest charge band. This applies to both the largest and smallest firms in our sample of firms including those operating capped workplace schemes.

2.27 For the largest firms, the increase in the proportion of savings invested within the lowest charge band has coincided with a decrease in the proportion in the 0.5-0.75% charge band. Large firms overall show little change in the proportion invested across other charge bands, although the very small proportion invested in the highest charge band (charges greater than 2%) has decreased.

2.28 The picture for small and medium firms is mixed. Medium firms in our sample saw a reduction in the proportion of savings in the lowest two charge bands between 2017 and 2019. The smallest group of firms in our sample showed a decrease of funds in the 0.5-0.75% charge band, yet an increase in the proportion of funds charging below 0.5%. These patterns may be partly due to changes in the workplace pensions books for some firms, for example due to transfers. We also saw an increase in the proportion of assets in the 1.5%-2% band for medium sized firms. Our findings suggest this is mainly because 1 firm and IGC had not included all workplace pensions in the earlier years of the IGC's operation. The schemes that were later added to those overseen by the IGC mainly included members invested in higher charging self-select funds.

2.29 Overall within the non-legacy workplace schemes the figures from our sample of firms suggest that for larger firms, there has been an increase in the number of members invested in the lowest charging funds. For medium firms, the largest change is the increase in savings invested in the 1.5%-2% charge band, mainly due to the inclusion of schemes not included in the 2017 data.

Does the IGC appropriately assess the level of charges borne by policyholders? What are the range of charges in the market?

2.30 There was a wide variance in charges across all types of schemes, both legacy and those used for auto-enrolment even for different schemes in the same firm. Many IGCs appeared to accept that charges in schemes were offering value, but it was unclear how they decided this or what specific measures or benchmarks were used to reach this view. This was more likely to be the case for legacy schemes, where the 1% yardstick used by the Independent Project Board (IPB) seemed to be automatically viewed as a level which provided VfM. A 1% charge for legacy policies should not be assumed as VfM and may be poor value for some consumers in these schemes. New workplace schemes are capped at 0.75% although many schemes offer charges below this. IGCs should therefore assess whether charges at, or under these levels offer value for money on an ongoing basis.

2.31 Charges for different groups or cohorts of members varied across firms and schemes. The effect that charges have on pension funds can vary considerably for different cohorts. Members with small pots can be adversely affected by fixed charges such as policy fees. Similarly, charges such as exit charges, which are sometimes applied when pension funds are transferred to other schemes or when pension benefits are accessed on early retirement, can affect older members.

2.32 Most IGCs were taking account of the needs of different cohorts, and some actively challenged their firm which resulted in the firm cancelling exit charges and taking steps to ensure that small pots were not unfairly affected by charges. For example, 1 IGC identified that exit charges were particularly harmful for members with small pot sizes of under £5,000, and challenged the firm. This led to the removal of those charges.

2.33 A small number of IGCs showed they had a clear view of the level of charges that would, in their view, provide members with VfM. This was generally due to the IGC having clear benchmarks against which charges were actively measured. Where a clear VfM framework was in place with defined benchmarks, we tended to see better outcomes for members.

2.34 A few IGCs only reviewed and assessed charges affecting some members of schemes within their remit, for example only those with default investments. This meant that VfM was not being properly considered for all members of relevant schemes. These IGCs are not acting in line with their minimum term of reference, in breach of FCA rules (see COBS 19.5.5R(2)).

Good practice

One IGC had detailed benchmarks and metrics in place to compare the firm's charges against those of other firms in the market, in addition to comparing the IGC's own performance with other IGCs. It was easy to see how the different components of VfM helped inform the IGC's ratings.

Poor practice

Legacy schemes sometimes have valuable guarantees in place, such as guaranteed annuity or minimum growth rates. It was unclear for some of these schemes how the IGC had 'weighed up' the value of these when considering whether costs and charges provided VfM.

More broadly, a number of IGCs thought that charges were acceptable or provided VfM for their members without showing how they had reached that conclusion.

Does the IGC appropriately assess the level of transaction costs?

2.35 Since January 2018, the FCA has required asset managers (firms that manage investments on behalf of pension schemes) to provide transaction costs information to the firms operating pension schemes. These are costs incurred in the buying, selling, lending or borrowing on investments held in funds. They can either be clear to see, such as broker research costs and taxes such as stamp duty, or they can be less obvious costs, such as the difference between the buying and selling prices of investment assets, or the fees charged for processing these transactions by 'clearing houses'.

2.36 IGCs have a duty to assess transaction costs as part of their VfM assessments. In some instances, it was clear that IGCs had requested this information from firms, but it was not always provided in good time or in a consistent manner. Some of this was due to asset managers not being responsive to firms, however IGCs were not always proactively chasing the firm for this information. Asset managers are obliged to disclose all costs and charges and we do not expect IGCs to struggle to get this information and need to chase for it. Where IGCs have taken reasonable steps to get information but have been unable to do so, they should explain in their annual report why this is, and how they will take steps to get access in the future.

2.37 Equally we would remind pension providers of their duty to take reasonable steps to provide their IGC with the information reasonably requested to carry out its role effectively.

2.38 Where transaction cost information was provided, it was not always complete and covered only some investment funds and not all. Some IGCs reviewed these charges systematically for all the available funds, comparing to others within the industry and encouraging reductions where appropriate. In some instances, IGCs either did not show these were being reviewed, or did not comment on whether they felt the costs were appropriate.

Good practice

One IGC used the services of an external consultancy firm to help it assess whether the transaction costs were reasonable for the types of funds its members were invested in. The consultancy firm was able to compare costs against other similar types of funds in the market.

Does the IGC appropriately assess whether firms review default investment funds and performance?

2.39 Under their 'Terms of Reference', IGCs must assess whether firms review default investment funds and the performance of investment strategies. They should also satisfy themselves that these funds have been appropriately designed to meet the needs of those members. Members that are invested in these funds tend to be less engaged with their pension, so IGC scrutiny is extremely important to protect the interests of these customers.

2.40 Some IGCs were actively reviewing the design and investment performance of default funds. A number of these looked at whether the investment strategy was appropriate for different cohorts of members, for example those with a long term to retirement or those close to taking their benefits. Some used benchmarks to compare the fund performance against other default funds within the market, whereas others only measured against the fund's own benchmark.

Outcome 3 – The IGC raises concerns with the firm and effectively influences/challenges it to take necessary action(s).

2.41 Under this objective we considered whether IGCs showed they could influence firms to take effective and timely actions to improve VfM for members. Where they were dissatisfied with the firm's progress we assessed how the IGC challenged the firm to take action, including escalating concerns to the firm's governing body (usually the Board) or to the FCA where it was dissatisfied with the firm's response.

2.42 The success of an IGC should be measured in the improvements that it is able to make for its members. This is dependent on the willingness of firms to listen and respond to the IGC's views. But the determination of the IGC and the approach it takes to identify, prioritise and advance VfM changes is also important.

2.43 We found IGCs were not always effective at ensuring firms prioritised or made changes in a reasonable time. It was sometimes unclear when actions were to be completed. A small number of IGCs provided strong challenge to firms and ensured that firms delivered improvements for members. In some instances, we found IGC concerns were escalated to the board and in 2 instances, where the IGC was still not satisfied, they contacted the FCA.

Does the IGC influence and challenge firms?

2.44 A small number of IGCs prioritised their key areas of focus, set out what the intended outcome for members was, and communicated precisely what they wanted the firm to do. Where there was a clear timetable of actions and the IGC kept the firm focused on delivery, this generally resulted in positive improvements for members.

2.45 Some IGCs appeared to raise little to no challenge to firms even though the IGC had concerns about VfM. A small number of IGCs gave the impression that requesting information from the firm to complete a VfM assessment was evidence of the IGC's challenge.

2.46 Where the IGC had made concerns about VfM clear to the firm, some IGCs did not show they were following up to ensure when, or if, the firm would act on these. We saw examples where it took over a year for some actions to be started. It was not always evident from the minutes of IGC meetings or entries in IGC annual reports when these actions would be progressed, or what the IGC was doing to ensure the firm dealt with these.

Good practice

One IGC identified concerns that some members were invested in funds where charges were higher than 1%. They challenged the firm to review charges and reduce the number of funds that were available as some funds appeared very similar to others. The aim was for members to be able to choose a fund with an appropriate investment strategy more easily and ensure that charges were better value. This led to lower charges for nearly 13,000 members and improved the fund selection experience for members.

Poor practice

Some IGCs accepted the firm's reasons for not making changes or being unable to do so more quickly, without showing they had challenged or checked whether the firm's response was reasonable.

One IGC raised specific concerns about high charges. The firm explained these were due to the costs of advice to the employer being passed on through higher charges on members' funds. There is no evidence that the IGC challenged this or carried out any analysis to see whether this was reasonable, even though charges were much higher than other similar workplace personal pension schemes.

Has the IGC escalated concerns within the firm/to the FCA?

2.47 Where an IGC is not satisfied with the firm's response to its challenges we would expect it to escalate its concerns to the firm's governing body. If this does not result in a satisfactory outcome, the IGC can make its concerns public or escalate the matter to the FCA if the IGC thinks it would be appropriate. Since IGCs have come into force the FCA has only received 2 escalations from IGCs where they were dissatisfied with the firm's response to their challenges.

2.48 It was clear that a good proportion of IGCs had identified areas where VfM could be improved, but many failed to exert the necessary influence to get firms to take action. We saw very few examples of IGCs referring issues higher within a firm, for example to a firm's board. Where IGCs escalated issues, they generally managed to drive improvements more successfully, although this did not always result in change. We found 1 IGC had escalated a matter to the firm, but received no response. The IGC failed to follow this up and the issue did not seem to have been resolved.

Good practice

One IGC raised concerns about lack of diversification in the default fund and thought the investment strategy was unsuitable for members planning to using flexi-access drawdown at retirement. The firm was not responsive to the IGC but the IGC continued to make its concerns known. It also raised the matter with the firm's board and then escalated this to the FCA. As a result of the IGC's perseverance, the firm eventually made the required changes.

Poor practice

One IGC raised a concern with the firm over the clarity of the investment objectives of its fund. No action was taken to address this for over 18 months, but the IGC did not challenge the firm over the timescale and did not escalate this further.

One IGC was unable to assess whether the investment strategies were appropriate for members as the firm had not provided the information the IGC required. The IGC reminded the firm of their request many more times over an extended time period, but this was not referred to more senior managers or escalated to the firm's governing body.

Outcome 4 – Firms respond to IGC challenge and take appropriate action in a timely manner.

2.49 Under this objective we considered how firms gave information and resources to IGCs and how they responded to IGC challenge.

2.50 Firms have a responsibility to take reasonable steps to ensure that the IGC continues to comply with its Terms of Reference. This means that it must give the IGC the necessary resources and all information reasonably requested by the IGC to carry out its role effectively. They must also take reasonable steps to address IGC concerns. The firm is also required to give a written response where it has significantly departed from advice or recommendations made by the IGC to address concerns it has raised. Firms will likely be better able to ensure IGC matters are given proper attention within the firm if the relationship with the IGC is managed by someone within the firm holding an FCA significant-influence or designated senior management function.

2.51 Most firms gave the IGC adequate resource, but there were several instances where support to the IGC fell short. We found that the way firms responded to IGCs was variable. Generally larger firms gave information and support to the IGC more consistently. In some smaller firms, the IGC's role appears to have been considered less important, with information being given in an irregular way, making the IGC's role more difficult. There were also marked differences in the level and frequency of interaction with the IGC, with some firms having frequent interaction with the IGC, but others appearing to have had little to no contact or involvement.

Has the firm given sufficient information and resources to the IGC?

2.52 Most IGCs appeared to have been given adequate resources, including training, to be able to carry out their role effectively. Some firms also gave the IGC funding to get independent advice, or to take part in cross industry work, for example, in benchmarking. We found a few instances however, where IGCs were not given sufficient support to function properly. These tended to be isolated and usually short-term problems, but in a few cases, were only rectified after challenge or escalation by the IGC.

2.53 Most firms ensured that the IGC was given the information it needed at the right time. In some instances, firms were not giving everything that was needed, or were not giving this in good time. One common weakness was in the provision of transaction costs data, where information was often incomplete or late. This was generally due to the failure of asset managers to collate the relevant data, leading to delays for nearly all IGCs. Some firms managed to get this information more quickly and completely through regular and persistent engagement with asset managers.

Good practice

One IGC had an agreement with the firm for an annnual budget allocation which the IGC was able to draw on as necessary where it wished to pay for external independent advice. This meant that the IGC was able to bring in additional expertise when it felt necessary without delay.

Poor practice

One IGC raised concerns about a lack of resource in their annual report. The firm responded by gving additional support to the IGC. However, this was not a permanent solution, and support fell to inadequate levels again. The IGC highlighted this concern again in another annual report. Eventually, the firm acted to increase support and appointed a senior individual to manage the IGC relationship.

One IGC requested information about members' investments a number of times, initially in 2017 and again in the following 2 years. This was also noted in the IGC's annual report. The firm's point of contact for the IGC did not know how to get the information but did not refer or escalate this for resolution.

Has the firm taken reasonable steps to address any deficiencies raised by the IGC/GAA in a timely manner?

2.54 Some firms showed they were responsive to IGC challenges and willing to implement changes without unnecessary delay. In these instances, actions agreed were clearly planned and it was evident who was responsible for overseeing delivery of the improvements. We found this was more likely where the firm had designated an individual to liaise with the IGC, take actions forward and ensure it received the necessary information.

2.55 In many instances, it was unclear whether the firm's response to the IGC's challenge was to accept or disagree with the proposed actions. We saw evidence of some IGC proposals taking several years to progress with no clear indication why the firm had taken so long. Firms did not always have a clear action plan or timetable for delivery and it was often unclear where accountability lay.

Poor practice

One firm took over 3 years to address the IGC's concerns about the asset allocation in the default fund. Due to a number of organisational and staff changes within the firm it was not clear who was accountable for the IGC. The concerns did not appear to have been properly considered by the firm's board.

Outcome 5 – IGC Annual Reports are of appropriate quality (content, transparency, readability) so that engaged scheme members, employers, and consumer groups can make effective use of them.

2.56 We looked at whether annual reports were written clearly and included enough information for members to understand whether they were getting VfM from their pension scheme. We also considered how IGCs reported any challenges or disagreements with the firm.

2.57 FCA rules require all IGCs to publish an annual report showing what the IGC's opinion is of the VfM provided by the schemes it oversees. This should include confirmation of the IGCs independence, the concerns or challenges the IGC has raised, how it considered all members' interests and the expertise and experience the IGC has to act in the interest of the members. When writing reports, we would encourage IGCs to consider whether information is presented in the report in a way that can be clearly understood by members, particularly where the information is complex.

2.58 Reports generally showed that IGCs were acting independently of firms and were forming their own judgements of the VfM firms were providing. In a small number of instances however firms appeared to be influencing IGCs, either by providing input to the report, commenting on the VfM ratings, or directly helping firms to draft the report. We remind firms of their obligations to take reasonable steps to ensure IGCs act and continue to act independently and within their terms of reference.

2.59 We found that there was a wide variation in the quality of annual reports. Most reports included all the key information required under FCA rules, but some lacked sufficient detail in certain areas. This included how challenges would be followed up, or how VfM ratings were reached. Members might be unlikely to understand all the information in some reports, as these contained jargon, or facts were not concise or clear.

Do the IGC's annual reports contain adequate information?

2.60 One report contained an explanation of the different scores the IGC had used to rate VfM. In some reports VfM ratings were shown without any context or clear indication of how these were decided. In 1 example, an IGC had rated the firm 'good' across all VfM areas when charges were noted elsewhere as being high for 1 fund.

2.61 Information on charges was not always shown for all relevant funds or cohorts. One IGC stated that its members were receiving good VfM, but charges were shown as an aggregate figure for all members, rather than showing the charges for different cohorts.

2.62 Transaction cost information was also not fully detailed in all reports. Where this was due to the failure of the asset managers to provide this, IGCs were not always making it clear what action (if any) was being taken to address this.

2.63 There was often no clear relationship between a firm's VfM score and the challenges raised. Some reports showed IGCs had given a firm a low VfM score although no specific challenges had been raised, and it was unclear what action the IGC expected. For example, 1 IGC thought the firm was not communicating effectively with members and gave it a low rating in this area. However, no challenge was raised and the report did not state whether any action was planned or being taken by the firm to address the IGC's concern.

Good practice

One report clearly set out the IGC's priorities from the previous year and what the firm's response had been to these. Priorities and areas of focus for the next year were also clearly recorded. One of these was to improve service standards. The report detailed the actions that were being taken and the target service levels that would show whether VfM was being provided.

Poor practice

One IGC failed to record any information about charges although this is a key area of VfM assessments. The report showed the IGC had concerns with 1 investment fund, but there was no explanation to show why. No challenge or concern was recorded about this or any other matters.

In 1 report the IGC had compared the performance of the funds against a benchmark without making clear what the benchmark was. Without this information it would not be possible for a member to judge whether the fund was providing fair returns.

Are the reports written in a way that is readable and capable of being understood by the average scheme member?

2.64 IGCs were generally careful not to use too much jargon or technical terms that would make the report difficult to understand. Most used a glossary to explain the terms used and some included explanations throughout the report, so readers would not have to refer to a separate section.

2.65 Readability of reports is not limited to the language used. We found that some IGCs used images, graphs, key facts and headers to break up large sections, of text, highlight key points and present information more clearly. Sometimes graphs or charts were complex or used without clear supporting information.

2.66 A few reports used case studies to help members better relate these to personal circumstances. One example showed how much smaller a pension fund might be in retirement if charges were a certain percentage higher. Messages presented in this way are likely to be more impactful for members by helping them see in actual pound terms how charges might reduce their savings.

Good practice

In 1 example, charts were used to help compare investment performance for members' funds to the returns of similar funds within the market . The accompanying text was free of jargon and easy to understand.

Poor practice

In a number of reports, IGCs did not provide sufficient information for members to get a clear view of whether VfM was being provided. In 1 example the IGC showed comparisons with a benchmark without describing what the benchmark comprised. In another example an IGC made no clear reference to charges within its VfM commentary, despite this being a fundamental component of its VfM work.

Outcome 6 – The IGC is effective at horizon scanning and planning for future priorities

2.67 Under this objective we considered how IGCs planned and prepared for future work and how they assessed their capabilities to ensure they have sufficient resource and expertise.

2.68 Firms are required to take reasonable steps to ensure IGCs have sufficient collective expertise and experience to be able to make VfM judgements for members. As set out earlier, IGCs should also show in the annual report how the IGC has sufficient expertise to act in their members' interests. We would expect firms and IGCs to review their capabilities where there are changes to IGC membership and when planning for future priorities they are required to implement. This will help ensure the IGC continues to act within its terms of reference.

2.69 Some IGCs showed they were looking ahead, thinking about the areas of work they may be required to take on and planning what additional expertise or skills they might need. A small number of IGCs did not seem to consider what might be on the horizon and only had broad, less specific plans.

2.70 Several IGCs regularly reviewed their own effectiveness, some on an annual basis. Through this they identified gaps in the IGC's competencies and skills and took steps to recruit new members with the required skills. One IGC used competency based assessments to ensure that new IGC members had the right skills and expertise for the role.

Good practice

One IGC completed annual reviews of its effectiveness. The results were used to identify gaps, help the IGC plan its priorities for the following year, and request the level of resources it would need.

Outcome 7 – GAAs are an effective alternative to IGCs.

2.71 Under this objective we considered whether the firm's decision to appoint a GAA instead of an IGC was reasonable based on the evidence available. We also explored the extent to which any shortcomings might be due to the appointment of a GAA compared to an IGC.

2.72 Firms must decide whether an IGC or GAA is appropriate for their pension schemes. They can appoint a GAA in place of an IGC after having regard to the size, the complexity and nature of the workplace pension schemes. For example, they may determine whether the scheme is a large scheme by reference to the number of members, the total value of the funds under management and the number of employers contributing to the scheme.

2.73 Where firms had appointed a GAA the reasons for this choice were not always clearly documented. We did not, however, find any evidence to suggest these firms should have set up an IGC instead. Most firms kept this decision under regular review, either annually or on a continual basis.

GAA-specific findings

2.74 Most GAAs had completely independent membership, although 2 GAAs also had firm employees as committee members. Completely independent arrangements tended to be less able to get the firm to give the information required or act on GAA concerns. One reason for this might be because these GAAs lacked the benefit of a firm appointee that could help drive forward agreed actions within the firm.

2.75 GAAs were less likely to challenge a firm when dissatisfied with the firm's response or an aspect of VfM. Challenges were generally little more than requests for information, and we saw no evidence of escalation, despite instances where this was warranted. In 1 example, the firm was asked for information on investment portfolios many times over a number of years. The GAA periodically chased the firm and recorded this in the annual report. However, the firm did not respond and do not seem to have given this appropriate attention or priority.

2.76 The fee structure for GAAs was on a fixed fee basis, where costs were agreed for the year, regardless of time considerations. Some did not appear to have enough resource to fulfil their roles properly. In several instances 1 GAA held meetings without a quorum of committee members, to reduce costs. Another GAA seemed to lack the necessary secretarial support and did not routinely record minutes of meetings.

2.77 GAAs did drive some VfM improvements within firms. One GAA in our sample had developed a comprehensive VfM framework. When compared to IGCs, however, GAAs appeared to operate in order to meet the regulatory requirement to exist. Although deficiencies at firms were highlighted, GAAs were not generally effective in influencing firms to make changes.

Annex 1
Abbreviations used in this paper

AUM	Assets under management
COBS	Conduct of Business Standards
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
GAA	Governance Advisory Arrangement
IGC	Independent Governance Committee
IPB	Independent Project Board
OFT	Office of Fair Trading
TPR	The Pensions Regulator
VfM	Value for money

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Pub ref: 007170

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