Dear Mr. Burton,

FairPensions welcomes this opportunity to respond to The Pensions Regulator’s consultation, ‘Enabling good member outcomes in work-based pension provision’. FairPensions (Fairshare Educational Foundation) is a registered charity established to promote responsible investment practices by pension providers and fund managers. FairPensions champions greater transparency and accountability to the millions of people whose long-term savings are managed by institutional investors and other professional agents. FairPensions believes that responsible investment helps to safeguard investments as well as securing environmental and social benefits. We are a member organisation and count amongst our members a growing number of globally recognised NGOs and trade unions, as well as over 8000 individual supporters.

FairPensions has recently produced a report, ‘Protecting our Best Interests: Rediscovering Fiduciary Obligation’, which explores the future of pension providers’ fiduciary duties to pension savers. The report includes recommendations for policymakers and regulators, including TPR, and for pension providers themselves. A copy of the report is enclosed. Since this report sets out our views on a number of issues relevant to this consultation, and is the outcome of a year-long research process in which Will Price of TPR has been extensively involved, the report forms the basis for our response.

Briefly, the key aspects of the report with relevance to this consultation are:

- Chapter 2: Do fiduciary duties extend beyond trustees?
  - The respective roles of trustees, asset managers and asset owners
  - Comparisons between trust- and contract-based arrangements as regards governance, legal duties and regulatory regimes
  - Small schemes
Question 2: Strengths and weaknesses of different segments

We broadly agree with the discussion paper’s assessment that smaller occupational pension schemes and work-based personal pensions where the employer is neither engaged nor advised are less likely to deliver good member outcomes. We also agree that, in these and similar circumstances, market forces cannot be expected to deliver good outcomes for members due to weakness on the demand side. As the discussion paper concludes, this necessitates clear responsibilities on the supply side, backed up by robust regulatory oversight.

In particular, we agree with the assessment at paragraph 45 of the difficulties with aligning agents’ interests with those of beneficiaries in such circumstances. We would suggest that insufficient attention has been devoted to trustees’ role in monitoring conflicts of interest throughout the investment chain, for instance in their asset managers and consultants. Trustees who took part in the research process for our report indicated that they felt insufficient training was available to them on this key aspect of their role, and we have therefore recommended that TPR seek to rectify this (see chapter 2, pages 45-46).

Chapter 2 of our report also finds that asset managers themselves may be insufficiently aware of their duty to manage conflicts of interest. We suggest that TPR should work with the FSA and FRC to ensure that they are addressing this vital deficiency which has the potential to significantly affect good outcomes for members.

We agree that members of work-based personal pension arrangements benefit from an engaged employer, for instance through management committees. As our report notes in chapter 2 (at pages 47-49), some have suggested that regulators should provide for a more formal role for employers in such arrangements, thus replicating some of the governance advantages of trust-based schemes rather than simply leaving members at the mercy of insurance companies. We believe there are advantages to such an approach, which could also help to improve consistency of protection across the market (see question 3) and clarify accountabilities in work-based personal pension provision (see questions 14-17). However, employer engagement must be complementary to, and not a substitute for, clear and properly enforced duties on providers themselves.

Question 3: Regulatory differences
Chapter 2 of our report (at pages 51-52) considers the different regulatory structures applying to trust and contract-based pension provision. This is in marked contrast to civil law jurisdictions which do not have the concept of the trust – such as South Africa – where all pension providers are subject to the same regulatory regime. We are concerned by the potential for arbitrary distinctions to arise between the protections offered to one pension saver and the next, simply by virtue of the form of their pension arrangements. For instance, as the discussion paper points out, many group personal pension arrangements with disengaged employers are little different from individual personal pensions, in that they rest entirely on a contractual relationship between saver and insurance company. Yet these two types of pension are governed by different regulatory regimes and, at least to some extent, by different regulators.

We agree that awareness of these distinctions among consumers, and perhaps even employers and trustees, is low. However, our report recommends that there may be a need to tackle the underlying inconsistencies rather than simply seek to improve understanding of the existing system. We suggest that TPR should seek to work with HMT, FSA and DWP to explore whether its powers and remit need to be expanded as part of a review of the consistency of consumer protection across the pensions market. HM Treasury’s current review of financial regulation, together with DWP’s review of regulatory differences between trust- and contract-based pensions, provides a good opportunity for this.

In particular, we agree with the discussion paper’s conclusion that market forces are unlikely to deliver good outcomes for certain types of contract-based provision (see page 50 of our report). We therefore suggest that there is a need to explore how the advantages of fiduciary obligation can be replicated for contract-based provision.

Questions 4 & 5: Small Schemes

We agree with the regulator’s assessment of the problems facing small schemes. Our report recommends that small schemes should be encouraged to migrate into well-governed large scale provision. In addition to the issues highlighted by the consultation paper, we would also point out that larger schemes will find it easier to devote resources to good quality member engagement and communication, which we believe is crucial to restoring trust in pension saving. We have recently been advocating government action to improve standards of transparency in pension funds, and the disproportionate burden imposed on small schemes by enhanced regulations is frequently identified as a barrier to such action. This discussion can be found on page 44 of the enclosed report.

Question 9: Costs and charges

We agree with the discussion paper that transparency on costs and charges is vital, and that unduly high charges contribute to mistrust of financial products among savers. Chapter 2 of our report, which considers the role of asset managers and investment consultants, is relevant to this question. As the report notes on p30, there is compelling evidence that the level of fees charged by investment agents does not necessarily correlate with the level of performance, and that fee bases are relatively ineffective at aligning agents’ interests with those of beneficiaries.
We particularly agree with the paper’s observation that annual management charges may not provide an accurate picture of costs if issues such as the level of portfolio turnover are not taken into account. During the research process for our report, one trustee reported that she had asked her fund’s asset managers for information about transaction costs associated with portfolio turnover, and had been unable to access it. We suggest that regulatory action may be needed to tackle this particular problem. Without transparency, trustees are unable to judge whether their agents are pursuing an investment strategy that aligns with the long-term best interests of members rather than the short-term interests of intermediaries. These issues are considered further in chapter 6 of our report.

Questions 14-17: Accountabilities

We agree that accountabilities can be much less clear in work-based personal pension arrangements than in occupational pension arrangements. Guidance from the regulator on the respective responsibilities of employers, providers, advisors and members might be helpful.

In particular, our report argues that there is a need for much greater clarity about the extent to which contract-based providers owe fiduciary duties to members, and if so, what those duties entail. The discussion paper notes that these providers are bound by FSA requirements to treat customers fairly. However, this requirement is much less stringent than the fiduciary duty of trustees to act only in beneficiaries’ best interests, as our report explores in chapter 2 (at pages 32-34). Moreover, the FSA itself has acknowledged that its approach has historically failed to ensure that consumers are protected in practice. Government action or legal clarification may be needed in this area. Meanwhile, TPR should encourage the FSA and/or the new FCA to take action to ensure that contract-based pension providers are clear about their responsibilities and that they are applied in practice.

However, lines of accountability in trust-based schemes are not always as clear as they might appear. Trustees increasingly delegate their fiduciary functions to external agents but cannot delegate their fiduciary duties. Due to lack of case law, it is unclear in practice where the responsibilities of trustees end and those of asset managers begin. The rise of ‘fiduciary management’ is an extreme manifestation of this trend and raises the question of whether further guidance is needed to clarify the respective roles of trustees and their professional agents in the investment chain. These issues are considered in chapter 2 of our report, at pages 37-46. On trustees’ ability to hold their agents to account, see also our response to question 2.

Chapter 3 of the report (pages 65-66) also provides a practical example, namely integration of environmental, social and governance (ESG) issues, where studies show confusion between trustees, asset managers and consultants about their respective responsibilities. This has led to key determinants of good member outcomes are neglected. We suggest that guidance from the regulator would be useful in this area.

Finally, although we agree that the generally passive role of members makes it particularly important that providers act in members’ interests and offer good default options, we believe this is compatible with much greater member involvement and transparency. Indeed, there is some evidence to suggest that high quality engagement and communication can help overcome the mistrust which puts many off from saving at all. Far from being an unaffordable luxury or a distraction from the basic
imperative of getting people saving, transparency and member involvement is therefore an essential tool in improving patterns of saving. This is considered in chapter 5 of our report, which recommends that TPR should seek ways to support schemes to engage with their members. For instance, this could include the provision of model surveys to ascertain members’ views, based on those used by The Pensions Trust or NEST. FairPensions is currently scoping some work of our own in this area and we would be pleased to work with TPR on this issue.

We would be pleased to meet with you to discuss any of the issues raised in this response.

Yours sincerely,

Catherine Howarth
Chief Executive, FairPensions