Donald Cranswick
Strategy & Competition Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Sent by email to JointPensionStrategy@fca.org.uk

Dear Mr Cranswick,

Regulating the pensions and retirement income sector: Our strategic approach

I am writing to respond to the FCA/TPR consultation on regulating the pensions and retirement income sector on behalf of ShareAction, a registered charity established to promote transparency and responsible investment ("RI") practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. We work with institutional investors to promote stewardship and engagement, and we also conduct annual industry-wide surveys to rank them on these activities.

Q1: FCA and TPR's remits intersect in some areas. Do you see this working effectively, or are there areas where this could be improved?

We believe there could be better consistency across rules and guidance in occupational and workplace pensions. There are clear parallels between the duties of providers under the FCA Handbook (for example, the Principles for Business (PRIN) and Conduct of Business Sourcebook (COBS) rules) and those of trustees of trust-based pension schemes. This is confirmed by a joint statement made by TPR and the FCA which stated that "The FCA expects pension providers to ensure that customers are treated fairly [Principle 6] in the same way that the Pensions Regulator expects trustees to act in the best interests of their scheme members".[1]

However, there is currently some inconsistency in the availability of rules and guidance on environmental, social and governance (ESG) considerations for contract and trust-based schemes. Members of contract-based schemes, overseen by the FCA, are exposed to the same risks as members of trust-based schemes, overseen by TPR. Trust-based schemes have clear guidance on how they should take account of environmental, social and governance (ESG) factors in investment, including climate risk; the same should apply to contract schemes overseen by the FCA.

For this reason, we were pleased to see that the FCA's announcement on 18 June 2018 saying that it intends to consult on rule changes requiring independent governance committees (IGCs) to report on their firm's policies on evaluating environmental, social and governance (ESG) considerations, taking account of members' ethical concerns and stewardship. We were also pleased to see that the FCA plans to consult on introducing related guidance for providers of workplace personal pension schemes on these areas. We would strongly encourage the FCA to follow the lead of the Department for Work and Pensions (DWP) in putting forward strong, robust proposals for consultation. We would also recommend that the regulators are clear about their approach to these factors in their joint strategy, with particular attention to climate risk as a systemic risk. This should include encouraging both contract and trust-based pension providers to

[1] The Financial Conduct Authority (FCA) and The Pensions Regulator (2014). *Guide to the regulation of workplace defined contribution pensions*. Available online: https://www.fca.org.uk/publication/finalised-guidance/workplace-defined-contribution-pensions-guide.pdf [accessed 19 June 2018].

report in line with the recommendations of the Task Force on Climate-related Financial Disclosures, as well as their advisors and managers.

Q2: Do you agree that the areas we have identified are the right ones? If not, which themes would you add or remove from our list? In which areas could the FCA and TPR singly or jointly have the most impact?

We broadly agree with the areas you have outlined as priorities for the joint strategy. We have expanded on some of these below.

We also support ClientEarth's recommendation that the FCA and TPR should engage with the Government on producing adaptation reports as part of the third round of reporting under the Climate Change Act 2008.

Getting people off to good start: access to pensions

Automatic enrolment (AE) has been a great success in ensuring greater numbers of people, particularly young workers, are saving for a pension. However, research[2] indicates current contribution levels (even after the rise to 8% by April 2019) is unlikely to generate adequate retirement incomes. Therefore, there is scope to ensure both TPR and the FCA encourage AE providers to find ways of innovating to rectify this problem. A key focus should be on improving communication and engagement by AE pension providers.

Research by ShareAction has found great dissatisfaction by pension savers about communication from their scheme, and low levels of engagement by members. Only 19% of UK workers have reported being happy with the communication strategies about their employee benefits,[3] while active registration with the online platforms of AE providers is typically under 10%.[4] The FCA and TPR should encourage greater innovation, particularly in the digital space, by pension schemes, to ensure people are actively engaged with their pension schemes and the accumulation of their retirement income. To take one example, apps can be developed so people can easily check their pension pot online, and both regulators can champion such innovation by schemes. Both regulators should also require schemes to annually report on their member engagement strategies. This would help ensure the objective of ensuring effective access to, and engagement with pension providers is delivered upon.

Making sure pensions are well run and funded: effective governance and secure funding

We feel that there still a paternalistic attitude in the pension system, originating from the DB pension system. It is no longer appropriate in an increasingly DC world. We often see a real resistance to allowing members to have a dialogue with the people who make decisions on their behalf. This is less problematic in the governance structures of trust-based pensions, where trustees are duty-bound to act in members' best interests. It presents more significant issues in the world of contract-based pensions. In our research and engagement work, we have experienced resistance from contract-based providers in relation to changing their product offerings, even where it may be in the best interests of members, if they do not see a sufficient demand from the 'client' (i.e. the employer). Many employers who choose a contract-based product are focused on simply meeting their duties under AE. Therefore, the likelihood of them having the resources, interest or knowledge levels to request specific kinds of pension product is quite remote. Where an employer does make a request for a specific product, providers may still reject this on the basis that the employer in question is too small and there is not a commercial case for agreeing to their request.

IGCs were introduced to fill this governance gap, following the Office of Fair Trading's findings in 2013 of the 'weak buy-side' in contract-based pensions.[5] However, our experience of reviewing

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[2] Pensions Policy Institute. (November 2016.) The Future Book: Unravelling workplace pensions, p29. Available online at: http://www.pensionspolicyinstitute.org.uk/publications/reports/the-future-book-unravelling-workplace-pensions,-secondedition-2016 [accessed 19 June 2018].

[3] ShareAction (2018). *Pensions for the Next Generation: Communicating What Matters*, p2. Available online at: https://shareaction.org/wp-content/uploads/2018/03/NextGenerationPensions.pdf [accessed 19 June 2018].

[4] Ibid, p4.

[5] Office of Fair Trading (2014). Defined contribution workplace pension market study (updated version). Available online at: http://webarchive.nationalarchives.gov.uk/20140402194810/http:/www.oft.gov.uk/shared_oft/marketstudies/oft1505 [accessed 19 June 2018].

IGC reports and engaging with them suggests that there are still significant problems with this model. Most of these problems seem to relate to the fact that the IGC has no decision-making powers and is reliant on the provider for their appointment and resources. Some IGCs are doing much less than others to address the value for money issues in their provider's offering. For example, one provider's customers are paying nearly three times the charge levied by the majority of other providers, but the IGC seems to be unwilling to push for a charge cap or refer the provider to the FCA. There is also a widespread resistance among IGCs to conducting a transparent and comprehensive comparison or benchmarking exercise between the providers. If this kind of work is not undertaken, we find it hard to see how customers can be sure they are receiving value for money.

For this reason, we would strongly encourage the FCA to conduct a full and public review of how effectively IGCs are working to ensure consumers receive value for money in contract-based pensions. This is particularly important given that we understand the FCA is considering using the IGC model in other areas of pensions.

In addition, both the FCA and TPR should do more to promote diversity on IGCs and trustee boards respectively. For example, a ShareAction survey of 11 major AE providers found that eight of these have IGCs/trustee boards with less than 30% female representation.[6] The research commissioned by the FCA from Anna Tilba, Michelle Baddeley and Yixi Liao[7] identified key challenges facing pension trustee boards, such as asymmetric information and overreliance on advisors, groupthink and overconfidence bias. They commented that increasing diversity on boards can be an effective way of countering these challenges – for example, increasing gender diversity tends to reduce overconfidence bias.

Increasing accountability can also help strengthen governance. We would recommend that both the FCA and TPR encourage pension schemes under their remit to hold Annual Member Meetings, so savers can enter into a dialogue with decision-makers and raise any concerns they may have.

Supporting good choices and outcomes for consumers and members

Provision of accessible information is required to support good choices and outcomes being made. For example, ShareAction's research has found that 54% of savers we surveyed had difficulty finding information on their scheme's website on how to switch from their default investment fund.[8] We are not commenting on the wisdom of selecting one fund in particular, but want to highlight that while there is a dearth of information, members will find it more difficult to make the best choice and achieve the best outcome.

Q3: Given our regulatory remits, what more, if anything, should the FCA and TPR do to support people as they start to save in a pension?

We would underscore the fact that promoting better communication and engagement by schemes with their members would be an effective way to support people as they start to save in a pension. For example, there is considerable interest amongst the millennial demographic (great swathes of whom are now pension savers as a result of AE) in responsible investment (RI) and the impact their money has on the world. The regulators should encourage schemes to develop stronger engagement strategies. For example, a 2016 survey by Legal & General Investment Management found 84% of pension scheme members would prefer a pension that uses investment to encourage companies to be more responsible.[9] Even when pension schemes have relatively comprehensive RI policies, their communication of the policies is lacking. ShareAction found in our AE survey that NEST had the most effective approach to managing environmental, social and governance (ESG) risks, but communication of this to its members - many of whom would be enthused by this – was relatively poor.[10]

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[6] ShareAction (2018). *The Engagement Deficit,* p49. Available online at: https://shareaction.org/wp-content/uploads/2018/06/TheEngagementDeficit.pdf [accessed 19 June 2018].
[7] Tilba, A., Baddeley, M., and Liao, Y. (2016). *Research Report on the Effectiveness of Oversight Committees: Decision-Making, Governance, Costs and Charges.* Available online at: https://www.fca.org.uk/publication/research/tilba-baddeley-liao.pdf [accessed 19 June 2018].
[8] ShareAction (2018). *Pensions for the Next Generation: Communicating What Matters*, p26. Available online at: https://shareaction.org/wp-content/uploads/2018/03/NextGenerationPensions.pdf [accessed 19 June 2018].
[9] Ibid, p13.
[10] ShareAction (2018). *The Engagement Deficit,* p15. Available online at: https://shareaction.org/wp-content/uploads/2018/06/TheEngagementDeficit.pdf [accessed 19 June 2018].

The interest young savers show in RI should be capitalised on to create active engagement with and support for these savers. Once their interest in RI-related aspects of their pension scheme is established, other areas which they may not have previously engaged with can be explored as well.

Q4: Is there more scope for TPR/FCA working, either singly or jointly, in this area? To what extent should the emphasis be on collaboration with a wider group of bodies to improve the advice and services supplied to schemes (e.g. administrators, investment consultants)?

We would advise that to promote effective governance, the FCA/TPR's joint strategy should engage with the following groups.

Investment consultants

Investment consultants wield considerable influence within the pensions sector, since pension trustees are required to seek professional advice on their investment strategy. The investment consultant sector has not historically received much scrutiny, but it is currently under review by the Competition and Markets Authority. Research from the PRI[11] has raised concerns that the advice on investment strategy does not always factor in ESG financial risk, and its long-term impact on returns. While we appreciate the FCA does not have the power to regulate consultants, we would encourage the joint strategy to look at constructive engagement with the industry on these issues. Effective scrutiny of the advice given by consultants will ensure better governance.

'Non-professional' trustees

Consideration should be given to so-called 'non-professional' trustees who sit on pension scheme boards. Member-nominated trustees are not always well-equipped to fulfil their role effectively, especially compared to their 'professional' counterparts, who often have greater experience of the financial services industry. However, research[12] indicates that they often play a valuable role in asking difficult questions and disrupting group think. The FCA/TPR joint strategy should consider how best to support member-nominated trustees and member representatives on IGCs, so they are effective in exercising their role. This could include working with the Government to look at options such as amending the Employment Rights Act 1996, so that member representatives have the same rights to request reasonable time off work to fulfil their duties as magistrates, school governors and other roles prescribed in the legislation.

The Single Financial Guidance Body (SFGB)

This (yet to be named) body created by the Financial Guidance and Claims Act 2018 will amalgamate the functions of the Pensions Advisory Service, Money Advice Service and Pension Wise. It is important that this new body plays a constructive and holistic role with regard to improving pension member outcomes, and the FCA/TPR strategy should incorporate this. For example, levels of pension awareness and understanding across the general public are relatively low. The SFGB should publish clear, engaging information about pensions to ensure people are better informed about their pensions and can take action to ensure they receive good outcomes. It should help consumers to understand the importance of starting to contribute to their pension early on and continuing to contribute throughout their working lives. It should also highlight the need for consumers to understand and engage with communications from their pension provider.

Asset management firms

As the FCA is responsible for regulation of asset management firms, their relationship to the governance of pension schemes should be considered. There should be more effective scrutiny of

[11] PRI (2018). *Investment Consultant Services Review*. Available online at: https://www.unpri.org/download?ac=4394. Accessed 19 June 2018.

[12] ShareAction. (June 2015.) *Realigning Interests, Reducing Regulation*, p19. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 19 June 2018]; and The Pensions Regulator. (October 2015). *Trustee Landscape Quantitative Research: A report on the 2015 Trustee Landscape research*. Available online at: http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitativeresearch- 2015.pdf [accessed 19 June 2018].

how asset managers invest savers' money, just as there needs to be scrutiny of trustees and how they delegate this responsibility to their managers.

Encouraging scrutiny of the management of ESG risk should be a priority. We see a clear need for cross-departmental/regulator work looking at how different parts of the investment chain are incentivised to function in relation to pension funds. This should build on the 2013 Kay Review and focus on short-termism in capital markets. Ideally, this would be coordinated with HM Treasury and the Department for Business, Energy and Industrial Strategy in the context of the Green Finance Taskforce's recommendations.

Q5: How can pension providers and schemes, employers and other firms in the sector improve the security of the money and data they hold? What role is there for FCA and TPR in further driving up standards?

Not answered.

Q6: Are there any further opportunities for FCA and TPR to support the delivery of value for money, either singly or together?

We would encourage a broad focus on encouraging transparency in the pensions sector by both regulators. This can help deliver value for money and potentially encourage a race to the top, in this and other areas. The DWP's recent change to the law means occupational defined contribution schemes must disclose information on the costs and charges incurred by the scheme, as well as basic information on where the scheme invests its money. We would like to see more reforms in this vein to encourage transparency on value for money, and the broader governance of pension schemes.

Q7: How can FCA and TPR work, singly or together, to ensure that information and advice helps people make appropriate decisions? When are people most vulnerable to taking poor decisions?

Information made available for savers needs to be clearer and more accessible, using new tools and technology as appropriate for the saver group. ShareAction surveyed 1,015 members of defined contribution schemes, asking them whether they have considered switching from the default fund their scheme invests in. Some of those surveyed went on to switch funds. Of those who did not choose to switch, more than half (54%) said they could not easily find how to do so on their provider's website.[13] We cite this not to suggest that switching is the preferable option; rather, that the full range of options are not made clear to the saver. If the full range of options aren't made clear, we cannot be sure they are making the best decision. The regulators have a role in reversing this state of affairs. This should include considering the role of the SFGB in improving understanding and engagement with pensions. It could also carrying out targeted reviews of the communications produced by different schemes, and using this information to publish best practice case studies.

People are particularly vulnerable to making poor decisions in exercising their pension freedoms, as the FCA's research on this area demonstrates.[14] However, this usually results from a lifetime of mistrust in financial services and low levels of understanding of pensions. In addition, there are numerous issues that can have an adverse impact on pension outcomes across the course of a saver's working life but cannot be remedied in the few years before retirement. This could include the cumulative impact of fees and charges on a pension pot, or the need for schemes to adopt an investment approach that will produce sustainable long-term returns. We feel people should be able to receive and consider information and guidance on pensions throughout their lifetime. The aim of this information and guidance should be to ensure people are better informed about their pensions and can take action to ensure they receive good outcomes.

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[13] ShareAction (2018). *Pensions for the Next Generation: Communicating What Matters*, p26. Available online at: https://shareaction.org/wp-content/uploads/2018/03/NextGenerationPensions.pdf [accessed 19 June 2018].
[14] FCA (2017). *Retirement Outcomes Review*. Available online at: https://www.fca.org.uk/publications/market-studies/retirement-outcomes-review [accessed 19 June 2018].

Q8: Do you believe that the macro trends that we have identified are those most likely to drive change across the pensions and retirement sector? If not, what are the trends that matter? Which trends should be the highest priority for TPR and FCA? How will those trends (and any other drivers of future risks and opportunities) affect the areas we have identified?

We agree the macro trends identified will be influential in driving change across the sector. Feedback from the macro economy in particular be a factor, though it is a concern that certain macro-economic trends may not be effecting change in the way they should be. Our survey of AE providers found the default fund portfolios of many providers in effect present a 'climate risk lottery', with great variance as to how these funds are prepared for the transition for a low carbon economy. All but one of the providers we examined scored above 32% in our survey when rated on who they manage climate risk.[15] With this in mind, the regulators' strategy should consider how pension schemes can be encouraged to take substantive action to address climate risk, and how any failures to act may negatively impact on savers' pension pots in the long term.

The DWP is currently consulting on amending the law to reflect the findings of the Law Commission's reports in 2014 and 2017 on ESG (including climate risk) and ethical concerns in pension investment. The FCA has announced that it plans to consult on the Law Commission's parallel recommendations concerning contract-based pension schemes. As stated above, we would strongly encourage the FCA to follow the lead of the DWP in putting forward strong, robust proposals for consultation. We would also recommend that the regulators are clear about their approach to these factors in their joint strategy, with particular attention on climate risk as a systemic risk. This should include encouraging both contract and trust-based pension providers to report in line with the recommendations of the Task Force on Climate-related Financial Disclosures.

Yours sincerely

David O'Sullivan

Policy Officer, ShareAction

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[15] ShareAction (2018). *The Engagement Deficit,* p15. Available online at: https://shareaction.org/wp-content/uploads/2018/06/TheEngagementDeficit.pdf [accessed 19 June 2018].