



Institute  
and Faculty  
of Actuaries

# CP14/16 Proposed rules for independent governance committees

Response to the Financial Conduct Authority

14 October 2014

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Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



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### **IFoA response to CP14/16 proposed rules for independent governance committees**

1. The IFoA welcomes the opportunity to respond to the FCA's consultation on the proposed rules for Independent Governance Committees (IGCs). This response has been led by members who work with Defined Contribution (DC) pension schemes, with additional input from some IFoA members who work in life insurance.

#### **General Comment**

2. The IFoA broadly welcomes the introduction of IGCs; however, we have some general comments that we would encourage the FCA to consider:
  - a. The introduction of measures to improve governance for pension schemes should apply consistently for all members, whether they are in a trust based or a contract based scheme. Any steps the FCA could take with the Pensions Regulator (tPR) to develop a consistent regulatory environment should have beneficial effects in the longer-term.
  - b. These committees do not come at zero cost and, as has been demonstrated in the case of with-profits firms, additional regulation can mean less money is available to provide policyholder benefits. It is therefore important that IGCs provide members with value for money in relation to improved outcomes; particularly in terms of investment outcomes and charges.
  - c. It is possible that insurers with significant legacy books, with widely varying terms, may incur disproportionate costs to ensure the IGC performs its duties. Members should not suffer poorer performance as a result of having an older policy. There is a fine balance to be considered in this regard.
  - d. The proposed rules do not set out the exact relationship between the IGC and the Board. While this detail may be more than is required for this consultation, the practical operation of the IGCs will require co-operation with Boards. . We would anticipate that some of our members would be well positioned to take up positions on IGCs, working alongside other IFoA members who currently sit on the Boards, with whom the IGCs will inevitably work. Further clarification on how this relationship should work in practice would be welcome so we can support our members appropriately in their respective duties.

**Question 1: We would welcome views on the likely equality and diversity impacts of the proposed rules.**

3. There is likely to be merit in IGCs having a diverse membership that reflects the interests of providers, as well as the interests of policyholders and regulators. With this in mind, the IFoA would regard the selection of the most appropriately qualified candidates as the approach that is likely to give members the best outcomes.
4. There would also be merit in providing IGCs with the opportunity to share experiences in a regular forum that addresses important governance issues. While the circumstances of firms may differ, the pooling of shared experiences may create a broad bank of practical knowledge upon which all members of IGCs could draw.

**Question 2: Do you agree that deferred members of workplace personal pension schemes should be within the mandatory scope of IGCs?**

5. Within occupational schemes, trustees have a duty to consider the interests of all members, not just actives. It would appear reasonable that the introduction of IGCs should have a similar provision. This does not mean that deferred members could not be treated differently, but their interests should be considered.

**Question 3: Do you agree that individual personal pensions, other than those that originated as workplace personal pensions, should not be in the mandatory scope of IGCs?**

6. The IFoA agrees with this suggestion. Individual customers have made a choice of provider, often with the support of a Financial Adviser, and are more likely to be engaged - arguably negating the need for an IGC. However, this exemption should not apply to leavers of contract based schemes, even if they would be re-labelled as individual customers. Where this to be the case, deferred members would fall beyond the scope of IGCs, which would not be consistent with the intention set out in our response to Question 2. We would welcome confirmation from the FCA it believes the current regulatory environment offers the same level of protection of other policyholders' interests without extending the remit of IGCs beyond what is proposed.
7. If the regulation were retrospective, there would be a requirement to re-designate some Individual Personal Pensions (IPPs) as leavers from a Group Personal Pension (GPP). Given the numbers affected, this could be disproportionate. If regulation were prospective, it would appear unreasonable that any subsequent "forced" change to an individual status would be permissible, or indeed, desirable.

**Question 4: Do you agree that individual personal pensions should not be in the mandatory scope of IGCs, even where the employer contributes or facilitates payments?**

8. Where an individual has made the decision to opt-out of an employer sponsored plan, this would be a reasonable approach, particularly after all employees have been auto-enrolled.

**Question 5: Do you agree with our proposals for which firms will be required to establish and maintain an IGC?**

9. We agree that the remit of an IGC should include an employer making a direct payment to the pension arrangement for two, or more, employees. However, that should not prevent an IGC considering any schemes where there may be only one employee receiving contributions, but where it is possible for more than one employee to receive future direct payments.

**Question 6: Do you agree that IGCs may be established at a group level?**

10. Further clarity on what an “appropriately resourced and supported” IGC should look like in practice would be welcome. More specifically, it would be useful if the FCA could provide more detail on the circumstances in which it would conclude that the IGC is not performing its duties satisfactorily due to inappropriate resourcing, or inadequate support from the firm.
11. While there would not be an objection to a group IGC, the most important outcome is that the IGC meets its obligations properly. If a group IGC failed to achieve those, we would suggest its structure is reviewed and revised appropriately.

**Question 7: Do you agree that an IGC must have a majority of members independent of the firm and that the IGC Chair must always be independent?**

12. The IGC would ideally have a majority of independent members to ensure it can be considered independent in voting matters. However, it is worth noting that there is no similar requirement applying to trustees of occupational schemes, who do not have to be independent of the sponsoring employer (albeit obligations are placed upon them by trust law). If the independent members were not in the majority, there could be a case for regulation of IGC members similar to the requirements for trustees acting under trust law.
13. While there is benefit in having an independent chair, and this could be regarded as the norm, the chair should be the most appropriate member of the IGC to fulfil that role. Depending on the experience of the IGC members, it may be that the most suitable candidate may not be independent. Providing that a non-independent chair would not prevent the IGC meeting the FCA’s objectives, we believe there would be merit in keeping this option open.

**Question 8: Do you agree that an IGC should have at least five members?**

14. The IFoA does not foresee any particular challenge to having an IGC with a membership of five. However, we would welcome clarity to understand in what circumstances the FCA believes a membership of five would be inadequate, recognising that a larger membership would be more likely to incorporate the breadth of skills and knowledge.

**Question 9: Do you agree with our proposed definition of independence that would allow trustees of a firm’s mastertrust to be independent IGC members?**

15. The definition of independence does not preclude shareholders and policyholders as being independent. However, it is clear that activities of the IGC could cause a conflict of interest for such members. A more robust definition of independence would prevent such potential conflicts. The FCA may wish potential members of the IGC to declare such potential conflicts prior to taking up the role.
16. The IFoA does not foresee circumstances in which a trustee of the mastertrust could not be regarded as independent, provided the individual met the other requirements of independence.

**Question 10: Do you agree that we should not require firms to indemnify IGC members?**

17. Indemnities could be encouraged but they should not be essential. It seems acceptable to devolve decision making responsibility as to whether to indemnify IGC members to the IGC member and the provider in setting the terms of their contract. This would be broadly consistent with the position of occupational scheme trustees.

18. If the FCA takes the decision not to require firms to indemnify IGC members, this may deter some appropriately qualified individuals from sitting on IGCs.

**Question 11: Do you agree that members of the IGC, including the IGC Chair, should not be approved persons at this time?**

19. We agree that this is a sensible approach given the short timescales in which to establish IGCs. If the IGC does not function properly, the firm should appoint additional members, or replace existing members. In the future, the FCA should review the effectiveness of IGCs and review the need for members to be approved persons.

**Question 12: Do you agree that we should require firms to recruit independent IGC members through an open and transparent recruitment process?**

20. Yes, the IFoA also agrees the Chair should be involved in the recruitment process.

**Question 13: We would welcome views on the proposed duration of appointment of IGC members.**

21. The IFoA would welcome further clarity on the re-appointment process and, specifically, where decision making power rests within it. If the re-appointment were the sole responsibility of the firm, any member of the IGC who had challenged the firm may have concerns about the possibility of re-appointment. Therefore, as a minimum, the Chair, or any other independent member of the IGC, should have a direct input to the re-appointment process. A re-appointment should also be subject to challenge as part of an open process, so it is not regarded as an automatic re-appointment.

22. The suggested terms of appointments not exceeding 5 years, with a maximum of 2 terms, appear to strike the balance between experience in the role and maintaining the independence of the members of the IGC. The IFoA would also encourage staggered initial terms of appointment to ensure there are not too many future changes to the IGC's membership at one time.

**Question 14: Do you agree that we should permit the appointment of corporate persons to IGCs, including as the IGC Chair?**

23. Yes, this type of arrangement works well for occupational schemes. While there is no need for a limit on the number of corporate appointments, perhaps a restriction of one person per corporate firm on an IGC would be appropriate. We also agree that there should be no restriction on the Chair.

**Question 15: Do you agree that there should be no restriction on the duration of a corporate appointment?**

24. The IFoA welcomes the encouragement of rotation for corporate member representatives. However, the corporate appointment should be subject to the same restrictions as an individual. There is a risk the corporate could become too close to the firm. A long-term appointment may provide an impression of a loss of independence, which could undermine the work of the IGC, even if it were not the case in practice.

**Question 16: Do you agree that IGCs should consider in particular the value for money received by individuals enrolled in default funds?**

25. Yes, default funds should be a key area for considering value for money. In particular they should compare the default fund to other funds offered by the firm and also its

competitiveness *vis a vis* other default funds in the market. In addition, the IGC should consider the continuing suitability of the underlying investments in the default fund.

26. If the IGC is to act in the interests of members, it must consider value for money for all employees participating in the fund, especially given the possibility of varying charging structures for different sized employers.

**Question 17: Do you agree that, at a minimum, IGCs must assess whether the characteristics and net performance of all investment strategies are regularly reviewed by the firm?**

27. Yes, this should be a core function within the IGC's responsibilities.

**Question 18: Do you agree that, rather than mandating a particular approach, we should allow individual IGCs to determine how best to assess value for money?**

28. The topics covered from 4.15 onwards do provide useful guidelines for IGCs, but IGCs should have freedom to address what it believes to be the most suitable areas. We would encourage the FCA to work with tPR to develop a range of best practice assessments for IGCs to maintain a consistently high standard of governance across all schemes.

**Question 19: Do you agree that IGCs should be required, at a minimum, to review the three aspects of scheme quality proposed, and should consider other aspects as appropriate?**

29. The proposal is appropriate as a series of initial steps. As experience develops in relation to governance, specific guidance may be more suitable in future years reflecting lessons learnt.

**Question 20: Do you agree that IGCs should consider all costs and charges, as proposed? If not, what would you suggest?**

30. Yes, consideration of all costs and charges are relevant to assessing value for money. We note that this would require some firms to re-assess how they provide information; however, such information would be essential to the IGCs activity.

**Question 21: We would welcome views on how best to improve the disclosure of all costs and charges, and how we could transpose the industry standards for authorised funds to pensions.**

31. A key requirement would be to ensure that the fund managers of institutional funds used by providers disclose to the providers what the transaction costs (and other costs) are for those funds. If fund managers only do this for authorised funds, then it would not be possible for providers to give this information to the IGCs. Standardisation across the industry in how this information is supplied for all types of funds is necessary to enable sensible comparison for the IGCs and also to develop consistency in the format of IGC reports.

**Question 22: Do you agree that IGCs should be able to escalate concerns directly to the FCA, alert relevant scheme members and employers, and make their concerns public?**

32. There should be a clear escalation process, depending on the nature of the breach. An initial step would be to use a form of an Internal Dispute Resolution Process that would enable the firm to take rapid initial action. Subsequent escalation processes should be clearly established in order that the IGC can reference the FCA's ability to take further action, if necessary, including making public comment.

**Question 23: Do you agree that the IGC Chair should be required to produce an annual report and that the firm should be required to make this report publicly available?**

33. The description of 4.38 should be the template of the report. As IGCs become more experienced and competent, they may provide additional commentary of their activities and monitoring. IGCs should also be encouraged to consider firm-specific reporting that makes the reports more useful to members. Where the IGC covers a large range of different pension schemes, care will be required in the layout of the report to ensure it is clear to members, and employers, which parts are relevant to them. This may require multiple reports that are accessible for the relevant members, or employers, or alternatively, clear signposting within reports as to which sections are relevant for which members.

**Question 24: We would welcome views on where IGCs should focus their attention.**

34. The IFoA would agree an immediate focus on the legacy audit and how it affects firms, but other areas of immediate focus should be on a firm-specific basis. Where any previous regulatory activity has identified areas of concern, the IGC could endeavour to ensure that such areas have been addressed.

**Question 25: Do you agree that we should place a duty on the firm to provide the IGC with all information that it reasonably requests for the purposes of carrying out its duties?**

35. We agree with this principle and endorse the description in this section, which sets out a sensible basis for co-operation between Board and IGC.

**Question 26: Do you agree that we should place a duty on the firm to provide sufficient resources to the IGC as are reasonably necessary for it to carry out its duties?**

36. The IFoA would support this approach as a sensible and practical process. In respect of 5.17, the firm should not request the IGC to undertake work that lies within the responsibility of the firm, nor should the IGC expect to conduct activity for which the firm has responsibility. There may be a requirement for initial communication to clarify this, particularly in relation to the conduct risk assessment undertaken by the firm.

37. IGCs should also consider their own need to demonstrate value for money and the possibility of introducing disproportionate costs that do not benefit members in the longer-term.

**Question 27: We would welcome views on possible arrangements to ensure that member views are directly represented to the IGC.**

38. It is unlikely that member interests could be directly represented, but a "member interest" role could be similar to a Member Nominated Trustee in an occupational scheme. While there would be expense in undertaking the exercise, there may be merit in pursuing the idea to increase member interest in the governance of their retirement funds. Alternatively, it may be easier to establish representation from sponsoring employers, who would also have an interest in cost management.

39. A facility could be available, possibly online, for members to raise concerns to the IGC. This could be referenced in the IGCs report. It would also seem appropriate to expect the IGC to seek members' views on the key areas of the IGC's operation, possibly by conducting a survey.

**Question 28: Do you agree that the firm should make the IGC's annual report and terms of reference publicly available?**

40. Yes, if it is acting in the interests of members - non-publication of the annual report would seem to be at odds with the purpose of the IGC as a committee established to protect the interests of members.

**Question 29: Do you agree that we should place a duty on the firm to address concerns raised by the IGC or explain to the IGC why it does not intend to do so?**

41. Yes, if the firm does not respond, or does not have to act on recommendations of the IGC, the IGC would become a means of introducing additional layers of costs for no benefit. If firms do not respond, the IGC should report its concerns to the FCA.

**Question 30: Do you agree that GAAs should be allowed as an alternative to IGCs for firms with smaller and less complex workplace personal pension schemes?**

42. The use of the term 'GAA' may be confusing. It would be more transparent if every firm had to provide an IGC. Given the GAA will be performing the same role as the IGC, and should operate in the same manner, we would encourage the FCA to apply the same name, but with practical concessions on the structuring, or operation, of the IGC for smaller firms. It is paramount that members are not disadvantaged by the approach taken.

**Question 31: Do you agree with our proposals for the type of firms that can use GAAs?**

43. Our response to the previous question indicates our preference for a more limited IGC regime for smaller firms, or those with smaller number of schemes/members. These proposals do cover the key areas that would constitute a more restrictive IGC. Whilst the size measure is definitive, the more subjective aspects of the complexity of the pension schemes are important factors that need to be applied properly. The more complex the structures of pension products offered by firms, the greater the need for an IGC ensure the interests of many different types of members are taken into account.
44. If you wish to discuss further any of the points raised in this response, please contact our Policy Manager, Philip Doggart ([philip.doggart@actuaries.org.uk](mailto:philip.doggart@actuaries.org.uk) / 0131 240 1319), in the first instance.