Summary

- The rising popularity of contract-based schemes, coupled with the roll-out of auto-enrolment, persuaded the Financial Conduct Authority to introduce independent governance committees in April 2015.
- The FCA requires providers of workplace pension schemes – principally large insurance companies – to establish and maintain an independent governance committee.
- Some have questioned whether these committees can be truly autonomous.
- There is a danger IGC board members could feel beholden to the company they are scrutinising, and simply rubber stamp the insurer's decisions.
- One of the challenges for IGCs is to examine several decades of pension schemes, understand the different contracts and consider how a proposal from a provider will affect these as well as current business.
- Over the long term it will be much more powerful for IGCs to understand how scheme members regard the drivers of value for money.

Achieving goals

Charlotte Moore looks at whether independent governance committees (IGCs) have maintained a level of autonomy or if there is any room for improvement

The rising popularity of contract-based schemes, coupled with the roll-out of auto-enrolment, persuaded the Financial Conduct Authority to introduce independent governance committees in April 2015.

The key impetus for this new policy was a study conducted by the Office of Fair Trading in 2013, which revealed inadequate levels of competition, including the potential for conflicts of interest.

Steps needed to be taken to ensure there is a similar level of oversight for contract-based schemes as exists for those schemes run by trustees.

To address these concerns, the FCA requires providers of workplace pension schemes – principally large insurance companies – to establish and maintain an independent governance committee.

Autonomous?

But some have questioned whether these committees can be truly autonomous. Squire Patton Boggs partner Anthea Whitton says: "The insurer has to provide the budget for the IGC as well as the remuneration of the committee members."

This creates an inherent conflict of interest.There is a danger members could feel beholden to the company they are scrutinising, and simply rubber stamp the insurer's decisions.

Those competing desires can be minimised by appointing the right people to the committee. Whitton says: "Most reputable firms have recruited experienced individuals with good track records who are sufficiently heavy weight and experienced to be able to manage the inherent tensions."

The level of impetus is determined by the chairman of the committee. "There needs to be a strong chair to shape and drive the vision of the committee," she adds.

Scottish Widows head of fund development and analysis Iain McGowan

agrees. "Our chairman encourages the members of our committee to think as independent members and to approach every meeting with that attitude."

Ensuring a broad range of skills is also important. Royal London IGC chair Phil Green comments: "We have individuals in our committee who have strong individual skills that span investment, transaction costs and actuarial science." Each member is encouraged to focus on their strengths to ensure a complete understanding of the problems, he adds.

The initial signs are encouraging: insurance companies appear to be embracing the concept of an independent governance committee, PTL managing director Richard Butcher says.

Most workplace pension providers see this as a positive development, as it will set higher standards for their products and help to strength their position in the marketplace. "They are also genuinely open-minded about the areas they can improve," says Butcher.

IGC members are cognisant that communication needs to flow in both directions. Meanwhile, Scottish Widows independent governance committee member Tilly Ross says: "We must establish a robust and positive long-term relationship with Scottish Widows in order to be able to influence them."

The best solutions can be found if the insurance company understands what the committee is trying to achieve, while the committee appreciates any road blocks the company might face.

Further reassuring signals have emerged from the annual statements published in April 2016. Butcher says: "A number of IGCs have extracted concessions from the insurance companies they oversee."

Those concessions include reduction in charges and service improvements. Some have also managed to get budget to carry out consumer research budgets to ascertain what members' value from their pension provider.

Room for improvement

But while these are positive signs, there is room for improvement. Butcher says: "As evidenced by these annual statements, there is wide variation in the quality of the work that has been done by the IGCs."

"The more forward-thinking IGCs are aware that ensuring workplace pensions create long-term value for scheme members is not as binary as altering charging levels; it will continue to evolve"

Different committees have approached the issue from different directions. Some IGCs have negotiated down product charges, others have set return expectations. And some have made significant progress towards their goals, while others are still in the planning stage.

Whitton agrees: "There is considerable variation in the level of activity between the different IGCs."

It might be too soon, however, to draw negative conclusions: this is

only the first set of annual statements. Butcher says: "If the IGCs pay attention to their competitors that should reduce the differences when the second annual statement is published next year."

But it might be unrealistic to expect all IGCs to coalesce around a common set of outcomes. Sackers partner Helen Ball says: "Each insurance company has a very different business model with very different customer bases."

In addition, the scale of the task facing some committees should not be underestimated. Not only are these committees ensuring that new, auto-enrolled members are being fairly treated, but also legacy members.

For large insurance companies, which have often added scale by merging and acquiring other companies, those legacy issues can be sizeable. Ball says: "Insurance companies have long and varied histories that have attracted different kinds of businesses in the past."

McGowan says: "One of the challenges for IGCs is to examine several decades of pension schemes, understand the different contracts and consider how a proposal from a provider will affect these as well as current business."

Green says: "It's a complex task that requires a detailed understanding in order to determine what should be the areas of focus."

This task can be made more manageable by understanding the broad product groupings and understand of the drivers for value for money.

McGowan says: "Last year we ensured that common standards were applied across that back book of legacy schemes." That included removing exit charges and applying a cap on annual management charge of 1 per cent.

Insurance companies should be allowed sometime to bed in these committees before any further changes are made by the regulator. Ross says: "We are only 18 months into the process – it will take time for changes to be made and to be embedded in the industry."

Butcher says: "But that does not stop the FCA from ringing up some IGC and pointing out the areas of deficiency."

Others think the FCA should be actively reviewing the IGCs. The Pensions and Lifetime Savings Association suggested in 2014 there should be review of the committees once they were up and running.

"We were concerned that with IGCs having a purely advisory role, too much power would remain with the provider. We still think that a review would help dispel these concerns," PLSA deputy director of DC, lifetime savings and research Nigel Peaple mentions.

The more forward-thinking IGCs are aware that ensuring workplace pensions create long-term value for scheme members is not as binary as altering charging levels; it will continue to evolve.

More should be done to understand and address customer needs. McGowan says: "Over the long term it will be much more powerful for IGCs to understand how scheme members regard the drivers of value for money."

Workplace pension providers have always existed at arm's length to their customers, so they lack the level of understanding that a more consumer-facing company would have of its clients. Green says: "The provider simply does not know its customer as well as it should."

This has to change. Green says: "To address this issue, our IGC has just recruited a new independent member to our committee from the Royal London membership from a consumer background."

IGCs need to look to the future. Green adds: "Now is the time to think about the customer's future education and engagement needs." That will include a radical rethink of the tools and techniques used to talk to those consumers – a much more approachable style will be required.

Written by Charlotte Moore, a freelance journalist