

By email to [reinigorating.pensions@dwp.gsi.gov.uk](mailto:reinigorating.pensions@dwp.gsi.gov.uk)

13 November 2014

**Consultation – Better workplace pensions: Putting savers’ interests first**

**Response from ShareAction**

**About ShareAction**

ShareAction is a registered charity established to promote responsible investment practices by pension funds and other institutional investors. ShareAction also champions greater transparency and accountability by pension providers to the millions of people whose long-term savings are entrusted to the capital markets. We are a member organisation and count amongst our members a growing number of NGOs and trade unions, as well as over 24,000 individual supporters.

**Summary**

ShareAction commends the government’s efforts to improve governance standards and tackle charges in workplace pensions. The Office of Fair Trading’s report into this market<sup>1</sup> uncovered extensive evidence of practices causing member detriment which gives the government a clear mandate to intervene. However the proposals in this Command Paper could usefully be strengthened in several areas in order to achieve the policy aim stated by the Minister of State for Pensions:

*‘We must make sure workplace pensions are well governed, with competent trustees and managers and members’ interests at the heart of everything they do’<sup>2</sup>*

All occupational pension schemes should include member-nominated, or elected, representatives on the board of trustees, to ensure governance is aligned with member interests and sufficiently independent. Also, it should be possible for members of any occupational scheme, where they bear investment risk, to obtain information about the investment policy and portfolio, scrutinise the decisions made on their behalf and question scheme management. Pension scheme AGMs are the most appropriate way to achieve this and use of additional other mechanisms such as surveys, webinars and roadshows should be encouraged. While we would only expect a minority of savers to engage with such mechanisms, their existence would promote a culture of scrutiny and accountability that would improve outcomes for all members.

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<sup>1</sup> Office of Fair Trading, ‘Defined contribution workplace pension market study’, 2014

<sup>2</sup> Department for Work and Pensions, ‘Better workplace pensions: Putting savers’ interests first



ShareAction agrees that the requirement for the Chair of Trustees to produce an annual statement will help to focus minds and ensure compliance with governance standards. However the government is missing an opportunity to improve investment outcomes by not requiring the Chair's report to consider of long-term risks, including risks relating to environmental, social and governance factors. Such provisions could be mandated without creating overly burdensome or prescriptive compliance requirements.

We have responded only to the consultation questions that are within our area of expertise, or where we judge there to be scope for improvements to the policy or regulations.

## **Response**

### **Q3. Do the regulations achieve the policy intention of protecting against trustees being restricted to particular service providers, while allowing employers to set appropriate parameters around investments?**

Yes, ShareAction fully supports this regulation. A governance structure can only be considered fit for purpose if the trustees have the ability to move funds out of underperforming vehicles and terminate relationships with underperforming suppliers. We do not envisage any unwanted consequences arising from this regulation; it is still possible for an employer to set parameters around investments that they do not consider appropriate without requiring a particular service provider to deliver it.

The real issue though, is whether trustees will actually use their powers to switch service providers. ShareAction is particularly concerned about instances where large insurers have set up master-trusts, and the master-trust uses the in-house fund management services. In practice, it would be highly controversial for the master-trust to cancel a relationship with the parent company and use another service provider. If the trustees are beholden to the provider for their employment, recruitment to the board or re-appointment they are unlikely to challenge the provider in this way. Please see our response to question 6 for more details of our views on governance arrangements.

### **Q6. Do the draft regulations meet our policy intention of ensuring that occupational schemes are well-governed?**

ShareAction welcomes the government's commitment to improving governance standards in occupational schemes, in particular the obligation that will be placed on master-trusts to encourage members to make their views known to the trustees or managers. Such mechanisms will help build much-needed trust in the pensions industry which is necessary to encourage people to save for their pensions and therefore to ensure the success of auto-enrolment. However, this requirement in new regulation 29 could be strengthened. We do not think that schemes should be able to choose between having member nominated trustees (MNTs) on their board and communicating with the wider membership via an AGM, surveys or webinars; these mechanisms fulfil different purposes.

#### *Member representation and diversity in governance bodies*

The Department for Work and Pension's July 2013 Call for Evidence stated that one of the two essential features of good pension governance is 'an alignment of interests between people running the scheme and members of the scheme so that decisions are taken in the interest of the members'.<sup>3</sup> Unfortunately the proposed governance requirements for master-trusts outlined on

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<sup>3</sup>Department for Work and Pensions, 'Quality standards in workplace defined contribution pension schemes', July 2013, paragraph 21

page 12 are unlikely to achieve this. The proposals prioritise ‘independence’ at the expense of fund members themselves, or representatives that they have chosen, having a role in the governance of their own schemes. The definition of independence proposed may achieve independence on paper but this is no guarantee that the committee will actually exercise objective, non-conflicted governance in the best interests of the members.

Independent trustees who are appointed by the provider and dependent on them for reappointment can bring valuable skills and expertise, but may lack the motivation to challenge the provider. Also, the Command Paper acknowledges concerns that the pool of talent to recruit trustees from is narrow<sup>4</sup>, which shows that the same group of individuals may have multiple trustee positions for different schemes. This further reduces the motivation to challenge the provider because professional trustees seeking multiple appointments may well be unwilling to gain a reputation for ‘rocking the boat’.

It is disappointing that there is no requirement for member-nominated trustees in master-trusts. Although member representation is listed as an option that schemes can use for ensuring members’ views are directly represented<sup>5</sup>, ShareAction believes it is unlikely that schemes would choose this option unless it was mandated. The definition of independence on page 27 does not even make it clear whether an employer or member-nominated trustees could be used to fulfil the quota of independent trustees. As a minimum, the regulations should clarify that member and employer representatives are eligible for these posts.

We reiterate our suggestion that trustee boards should be composed of one-third member representatives, one-third employer representatives and one-third independent representatives, mirroring the structure of single-employer trusts. This would allay the problem of the recruitment pool for these posts being apparently so limited, amongst other benefits. Lay trustees would need to complete some training in order to be able to fulfil these posts, such as The Pension Regulator’s trustee toolkit. We do not agree with the assertion that member-nominated representatives may not be appropriate for multi-employer schemes. As an example, The Pensions Trust is a multi-employer scheme which has member-elected trustees on its board. In other countries such as Australia, the Netherlands and Denmark, member representation is mandated in industry-wide schemes that cover multiple employers, often at 50% of board seats.

We have been conducting extensive research on pension scheme governance for a forthcoming report, including conducting research interviews with a range of actors in the pensions sector. We have heard repeatedly that trustees who have worked for years in the financial services industry are often the least likely to challenge the status quo, not least with regard to questioning the fees paid to service providers.

As member representatives are not professionals, many MNTs have told us that they are more able to ask certain questions and challenge providers without the fear of appearing ‘stupid’, unlike independent professionals who have a reputation to uphold. As trustee boards reach decisions via voting or consensus, it is difficult to prove decisively how the presence of employer representatives or member representatives changes outcomes. MNTs repeatedly say, however, that even though they are not always experts, their presence on governing bodies tends to result in outcomes that are fairer for members than would be the case without them.

The Australian Superannuation system provides evidence that representative governance models are more successful at protecting scheme members’ interests than models where commercial

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<sup>4</sup> Chapter 2.94

<sup>5</sup> Chapter 2.128

providers appoint trustees. In Australia, all pension schemes are governed by trustees; for-profit retail schemes appoint two thirds of their trustees internally, or appoint trustees through executive search or personal contacts. Less than 5 per cent are elected by employers and none are elected by members. In the not-for-profit corporate, public sector or industry schemes, however, the majority of trustees are elected by employers or members or appointed by Unions or employer groups. The McKell Institute has provided comprehensive evidence that in Australia's Superannuation system:

*'the not-for-profit representative trustee model has outperformed its for-profit appointed trustee competitors on virtually every important criteria of superannuation performance over a long period. Although there may be scope for further improvement of the representative governance model, it promotes higher levels of diversity among trustees, more effectively minimises conflicts of interest and, importantly, has continually outperformed the for-profit model over the past decade, generating higher net returns for fund members.'*<sup>6</sup>

Using the latest data from the Australian Prudential Regulation Authority they show that the not-for-profit schemes with representative governance models generated risk-adjusted returns that were on average 2.4 per cent higher per annum than the retail pension funds over the last decade.

#### *Minimum number of trustees*

ShareAction is also very concerned that the minimum number of trustees for master-trusts will be set at three, rather than seven as proposed in the March Command Paper. The reasons for this outlined in Chapter 2.110 are not compelling; the problem of an apparently limited pool of candidates can be mitigated by encouraging the use of MNTs and ENTs. If smaller schemes find the governance requirements onerous, this may encourage consolidation in the markets towards fewer schemes of a greater scale which is clearly to be welcomed.

This proposal is not consistent with the widely accepted view that governance bodies, of pension schemes or other types of organisation, must contain a diverse membership and breadth of views in order to foster a culture of lively debate, robust decision making and willingness to challenge external stakeholders. The Government's own review of 'Women on Boards' in February 2011 concluded that:

*'it is clear that boards make better decisions where a range of voices, drawing on different life experiences, can be heard'*.<sup>7</sup>

The Association of Member Nominated Trustees<sup>8</sup>, the UNPRI and the Dutch pensions supervisory authority, De Nederlandsche Bank<sup>9</sup> have all recently called for trustee boards of pension schemes to become more diverse for these reasons. This diversity will not be achieved with 3 trustees, all recruited from a narrow pool.

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<sup>6</sup> 'The Success of Representative Governance on Superannuation Boards, The McKell Institute, June 2014

<sup>7</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31480/11-745-women-on-boards.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31480/11-745-women-on-boards.pdf)

<sup>8</sup> 'Does your trustee board have a women problem?', Pensions Expert, 2/09/2014, <http://www.pensions-expert.com/DB-Derisking/Does-your-trustee-board-have-a-women-problem>

<sup>9</sup> 'PRI calls for trustees to be 'brave' and consider long-term investing', Investment and Pensions Europe, 5/06/2014, <http://www.ipe.com/10002088.article>

## *Accountability and communication with the wider membership*

As we discuss in our 2013 report, *Our Money, Our Business*,<sup>10</sup> although direct representation of savers on decision making bodies is clearly an important accountability mechanism, it is not a substitute for direct engagement with the whole membership. Our conversations with MNTs suggest that many are uncomfortable with the idea that they hold sole responsibility for communicating with members and ensuring that their views are listened to.

All pension schemes should be required to hold an AGM, to which all members are invited and can directly question the trustees and executive management. The existence of such an annual forum would help build much-needed trust and confidence, even amongst members who do not attend. AGMs could be webcast and members who cannot attend could be allowed to ask questions in advance or via the internet, so that geography is not a barrier to participation. There is a precedent for pension scheme AGMs; the Legal and General master-trust recently held their first AGM which attendees and organisers considered to be a success. Local authority schemes also hold AGMs, which are often better attended than the AGMs of some FTSE 100 companies.

We also support providers holding webinars or roadshows where scheme members around the country can meet representatives from the provider. Apart from benefitting members, providers who do engage in these types of activities have told us that they find the feedback that they receive from members extremely useful and it helps to focus the providers' minds on the members' needs and views. Even if only a small proportion of members engage, the scrutiny of a vocal minority will improve outcomes for all members.

Contact details for the trustee board should be clearly displayed on the provider's website and distributed to members with their welcome packs and annual benefit statements, so that the members know where to direct their concerns about scheme value for money and investment policy. ShareAction maintains a tool on our website which makes it easy for savers to write to schemes with a query. We occasionally receive enquiries from savers whose scheme is not listed on our database and who are at a loss to know how to raise an investment issue with their provider. It is indicative of the level of disconnect between savers and their money that, in the absence of such tools, even asking a question is impossible for many people. This is why robust requirements around the mechanisms schemes can use to communicate with their members are required. The current proposals in new regulation 29 are too vague, which neither helps neither providers nor their members.

### *Single-employer trusts*

As communication with the wider membership achieves different aims than including MNTs in governance structures, it is entirely appropriate for the requirement hold an AGM, or use additional mechanisms like webinars or surveys, to be extended to single-employer trusts. Members of single-employer trusts who bear investment risk and have earned their contributions should also have the right to question scheme management at an AGM.

### **Q7: Do you have any comments regarding the policy on who should have the duty of compliance with the charges measures?**

It is entirely appropriate that this responsibility should rest with the trustees rather than the employers. We are concerned however, that the requirement for trustees to report only on the charges they have been able to find out will not result in effective action against inappropriate and hidden transaction costs. It is difficult for the trustees of even of the largest, best resourced

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<sup>10</sup> Available at [http://www.shareaction.org/sites/default/files/uploaded\\_files/investorresources/OMOB.pdf](http://www.shareaction.org/sites/default/files/uploaded_files/investorresources/OMOB.pdf)

schemes to find out this information. For example, Railpen recently revealed that additional underlying fees paid by the fund are around 300%-400% of the £70m upfront fees paid to managers.<sup>11</sup> It took Railpen 18 months to find out all the transaction costs that were actually being levied on members' savings. This shows the potential for member detriment resulting from transaction costs that it is difficult for trustees to gauge.

The onus should be on the asset managers to report all transaction costs to trustees in a clear, standardised way, rather than making trustees responsible for searching for this information. Although these regulations may not be the most appropriate place to achieve this, we encourage the government to act soon to introduce appropriate reporting requirements on asset managers.

**Q9. Do you agree with the policy on which the draft regulations are based (see regulation 3) – to capture as many workers as possible who made no active or informed choice about their investment strategy, whilst also minimising the risk of capping funds where members made an active choice?**

We do agree with the policy but are concerned that members who are not in default funds may not be adequately protected from excessive charges. Members who make an active choice cannot be considered to be fully informed, engaged and not needing robust protection. Our 2012 survey of UK ethical funds<sup>12</sup> found that funds that are marketed as ethical or green often have higher charges even though their investment approach may not be very different from mainstream funds. For example, only some basic ethical exclusions may be applied. Due to widespread misconceptions that ethical or green investments have lower returns and are necessarily more costly, some providers may feel they are able to take advantage of members who make an ethical choice by charging more.

**Q16. In addition to the questions already asked, is there anything else in the policies as set out in this paper on which you have any comments?**

It would be appropriate to include a review clause in these regulations. Perhaps in 2017, when the effectiveness of the charge cap is to be reviewed, the other measures to be introduced via these regulations should also be reviewed. For example the quality of Chair of Trustees' annual statements, the structure and operation of master-trust trustee boards and the effectiveness of methods that schemes are using to communicate with their members.

It is also very disappointing that these regulations do not in any way promote Responsible Investment (RI), being investment which takes account of long-term environmental, social and governance (ESG) risks which may affect investment returns. It would be appropriate for the trustees to disclose in the Chair's annual statement a forward looking assessment of risk, including how they have considered the long-term, ESG and systemic risks to the portfolio. The size of members' pension pots is of course affected by the fees and charges, but also by the investment returns so it is appropriate for these regulations to contain measures mitigating risks to the investment returns. As it is estimated that UK occupational pension funds will hold £480 billion in assets by 2030<sup>13</sup>, the way these funds approach long-term risk is critical for the future health of our economy as a whole.

RI also requires investors to take an active role as stewards in investee companies, exercising voting rights and engaging in purposeful dialogue with companies on ESG issues. As such,

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<sup>11</sup> <http://www.ft.com/cms/s/0/74691e26-52eb-11e4-9221-00144feab7de.html#axzz3ImUbeWlb>

<sup>12</sup> Available at [http://b3cdn.net/sactionlive/830475d6f9cd8ce119\\_ixm6b2ob6.pdf](http://b3cdn.net/sactionlive/830475d6f9cd8ce119_ixm6b2ob6.pdf)

<sup>13</sup> [http://www.theguardian.com/sustainable-business/2014/nov/06/new-pension-rules-give-businesses-480bn-to-invest-sustainably?CMP=share\\_btn\\_tw](http://www.theguardian.com/sustainable-business/2014/nov/06/new-pension-rules-give-businesses-480bn-to-invest-sustainably?CMP=share_btn_tw)

schemes used under automatic enrolment should be required to sign up to the UK Stewardship Code, disclosing whether and how they do comply with the code's principles. It would be appropriate to make this disclosure in the Chair of Trustees' annual statement. Given that the Stewardship Code is a UK government initiative, introduced to address a major systemic failing exposed by the financial crisis and directed at long-term investors such as pension funds, there would seem to be no justification for pension schemes being used under auto-enrolment not to be signatories to the Code. At the very least, schemes should be required (as asset managers currently are under FCA rules) to produce a statement of commitment to the code.

To improve accountability and transparency in pension scheme governance, schemes should also be required to disclose to their members information about the actual investment portfolio. As savers bear investment risk and have earned their contributions, it is appropriate that they have access to information about where and how their money is invested. Information about the top holdings and overall asset allocation could be included in the Chair's annual statement and made available on the website. Further information about other, smaller holdings should be available to members on request.