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By e-mail to transparencyDP@fca.org.uk 26 April 2013

Dear Ms. MacDonald,

We would like to respond to the FCA's DP13/1 on Transparency.

ShareAction (formerly FairPensions) is a registered charity established to promote responsible investment practices by pension funds and other institutional investors. In particular, we work to encourage active stewardship of listed companies through the informed exercise of shareholder rights. ShareAction also champions greater transparency and accountability 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 globally recognised NGOs and trade unions, as well as over 8,000 individual supporters.

We assist our individual supporters to engage with their pension providers about investment policies and practices, including shareholder engagement and voting decisions. In our experience such interaction is hampered by a pervasive lack of transparency. We also conduct research and benchmarking exercises using publicly available information about institutional investors' policies and practices, in order to inform the market and to promote best practice.

Transparency in relation to pensions and investments

We are pleased that the FCA has chosen so early in its tenure to address the question of transparency in relation to those it regulates and itself. The FCA's work is of interest to us because it regulates key players in the pensions and institutional investor markets, including contract-based workplace or personal pension providers and asset managers. At paragraph 5.2, the Discussion Paper identifies two important principles which could be promoted by increased disclosure, being (1) adjusting disclosure rules to help make products or markets more transparent; and (2) mandating firms to release more or different data/information on other aspects of their performance that could be used to compare firms.

We would like to highlight the importance of transparency in the wholesale markets. Consumers have an interest in the effective functioning of wholesale markets not only because of the impact of market failures on the wider economy but also because within these markets large sums of consumer money are managed by pension funds and their agents/intermediaries. In addition, it would be a mistake to assume that pension funds themselves are always 'sophisticated' investors capable of eliciting the information they need from their asset managers; as the Myners report observed over a decade ago, this is far from universally the case.[1]

As the Walker Review[2] and the Kay Review[3] have recognised, this consumer interest extends far beyond the point of sale and encompasses the ongoing behaviour of institutional investors, including as stewards of large listed companies. For example, in the aftermath of the financial crisis it was widely acknowledged that institutional investors had failed to rein in risky lending in the major banks they owned, and in many cases had actively encouraged banks to take on more risk in order to boost short-term profits. This resulted in massive consumer detriment not only to individual pension savers (in the aftermath of the crisis, pension funds lost an average of 17% of their value)[4], but also via the impacts of the crisis on the wider economy. In our view, it is important that regulators concern themselves with the systemic impacts of stewardship of invested assets, and not simply with the appropriateness of individual investment products to individual consumers.

We also note that pension products have features distinguishing them from other financial products. As Martin Wheatley noted in his recent speech at the London School of Economics[5], financial decisions often do not follow efficient market theories about consumer behaviour. Long-term investment products such as pensions are subject to a number of factors which exacerbate this tendency: they are highly complex; consumers often do not have a real role in their selection (for example, workplace pension providers are chosen by the employer, although the contract is between provider and employee); there is no repeat business; and poor performance may not become apparent until it is too late for consumers to act. These factors influence the competitiveness of the market for these products. As a 2008 paper by the OECD concluded, "*Given the complexity of investment matters and the long horizon of pension matters, expectations [that market forces will lead to efficient outcomes] may seem unwarranted.*"[6]

Disclosure, properly used, is a way to help counteract some of this complexity. However, regulators should not assume an efficient market model whereby disclosure will automatically lead to good outcomes for consumers. First, it should be recognised that disclosure has a role to play not only in enabling consumers to make better choices, but also in enabling better scrutiny of agents' behaviour as a mechanism for protecting consumer interests precisely where individuals do *not* have a choice about who manages their money (for example, where individuals are auto-enrolled into workplace pensions). Secondly, disclosure must be complemented by robust standard-setting; we fully endorse the Kay Review's recommendations regarding the promotion by regulators of fiduciary standards of care. The FCA's position on the need to go beyond 'caveat emptor' is

[1] Lord Myners, 2001, 'A review of institutional investment in the UK'
[2] Sir David Walker, 2009, 'A review of corporate governance in banks and other financial industry entities'
[3] John Kay, 2012, 'The Kay Review of UK Equjty Markets and Long-termism: Final Report'
[4] OECD: http://www.oecd.org/dataoecd/52/52/42204972.pdf
[5] 'The human face of regulation'. Published on the FCA's website on 10 April 2013.
[6] Stewart, F. and J. Yermo (2008), 'Pension Fund Governance: Challenges and Potential Solutions', OECD Working Papers on Insurance and Private Pensions, No. 18, OECD publishing

encouraging in this regard. For the reasons outlined above, it is vital that this approach be carried over to wholesale as well as retail markets.

The FSA's recent work on conflicts of interest recognised that there are significant failings within the asset management market, with senior management often failing to demonstrate that they understood and communicated a sense of duty to customers. Such a failing is deeply concerning given individual savers' heavy reliance on the diligence and good faith of those who manage their investments.[7] Savers also have an interest in a financial services industry which is characterised by relationships of trust, good governance and accountability. We believe that disclosure can be a mechanism for the promotion of such a culture. And, in addition to reputational benefits, increased transparency across the market can improve consumer engagement thus enabling firms to better meet consumer needs and to position themselves as attractive options for consumers.

As explained further below (see **Concerns about excess of information**), greater transparency in this area need not "overload" consumers with information and would empower those working on behalf of consumers to monitor the financial services industry and to use the disclosed information for the benefit of consumers. We also believe that it would help promote the FCA's strategic and operational objectives.

<u>Transparency of regulated entities</u>

Information to be disclosed

We are currently undertaking a research project to explore how the institutional investment system could be made more transparent and accountable to underlying savers. This project will report, with policy recommendations, in Autumn 2013. We have invited the FCA to participate in discussions to help us develop these recommendations. In the meantime, we would tentatively propose that the following areas of disclosure could be mandated by FCA rules:

Conflicts of interest

There are systemic conflicts of interest in the asset management industry. For example, conflicts may arise where investee companies are actual or potential clients, either of the asset management firm itself or of the parent company's investment banking arm. We are aware of considerable anecdotal evidence that these conflicts result in investment and/or engagement decisions that are suboptimal for beneficiaries.[8] In addition, conflicts arise where asset managers own shares in their own parent companies on behalf of clients and beneficiaries. Many asset managers do not disclose, possibly because they do not have, a clear policy on how these conflicts are managed, including for example how they take voting decisions with respect to their parent companies.

Asset management firms should have, and should be required to disclose, conflicts of interest policies which set out key areas where conflicts may arise and detail the procedures in place to ensure these conflicts are resolved in the interests of clients. The Stewardship Code currently requires signatories to disclose a policy on conflicts of interest related to stewardship, but our research has found that these policies are often inadequate.[9]

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[7] Traditionally people do not move their pension, even personal pension products. However, a more transparent market may lead to greater mobility of money and, therefore, competition.

[8] See for example, Wong, S., 'How conflicts of interest thwart institutional investor stewardship', Butterworths Journal of International Banking and Financial Law, Sept 2011

[9] FairPensions/ShareAction, 2010, 'Stewardship in the Spotlight', available at

Disclosure of investment policies
Pension savers have only minimal rights to information about how their money is invested. We believe that this lack of accountability is damaging for the industry as a whole as savers feel alienated from their money, thus adding to the severe lack of trust in the industry and reducing the likelihood that people will save.[10] We propose that those responsible for investing money on another's behalf should be required to disclose, and to keep up-dated, clear details of the following policies – and, crucially, to report annually on how these policies have been implemented:

- Investment policies, including how money is being invested.
- Policies relating to how the parties ensure responsible stewardship of investee companies, including those arising from the application of the Stewardship Code.[11]
- Policies relating to environmental, social and governance issues.

If there is, as we believe, value in institutional investors being accountable to the ultimate owners of those assets, those owners must be able to access, and to understand, the policies governing how their money is managed. We have also responded to this effect to the DWP's recent consultation on pensions disclosure requirements, and are engaging with DWP officials on this issue.[12]

Disclosure of stewardship and voting activities
Asset managers vote as shareholders on key issues relating to companies' strategies. As the Kay Report observed, the beneficiaries whose money is managed have an interest in how these votes are exercised, given their dependence on the success of these companies for a long-term sustainable pension income. As demonstrated in our 2012 report 'The Missing Link',[13] disclosure of voting activity is often limited, incomplete, difficult to find and/or lacking any clear explanation. However, full disclosure of voting decisions would provide a way for beneficiaries to hold to account asset managers (and the asset owners who appoint them, including insurance companies and pension funds). We believe that disclosure of voting activities by institutional investors should be mandatory[14] and that the FCA should require those it regulates to produce this information in a uniform and clear manner. Disclosure of voting leads to greater accountability by opening managers' decisions up to scrutiny and, in particular, highlighting inconsistencies in their voting policies. The possibility of such scrutiny will inform managers' behaviour by forcing them to consider the justification for their decisions.

Disclosure of other information relating to investors' holdings
Regardless of the point in the investment chain at which a pension provider, asset manager or other intermediary sits, they should be required by FCA rules to respond to questions from those whose money they hold/manage. Too often those who contact their pension providers with questions are told that the relevant decision has been passed to another party and that no information is therefore available. This damages the trust between

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http://www.shareaction.org/research/surveys
[10] The NAPF's Spring 2012 survey found that lack of trust was the number one reason given by people planning to opt out of auto-enrolment.
[11] On the limitations of the FSA's existing disclosure requirement in relation to the Stewardship Code, please see our previous consultation response at http://www.shareaction.org/sites/default/files/uploaded_files/FSAStewardshipCodeResponse.pdf
[12] See http://shareaction.org/sites/default/files/uploaded_files/policy/DWPdisclosureconsultation2013.pdf
[13] FairPensions/ShareAction, 2012, 'The Missing Link: Lessons from the 'Shareholder Spring', available online at http://www.shareaction.org/research/reports
[14] The Government has reserve powers to make voting disclosure mandatory (Companies Act 2006, s.1277)

beneficiaries and their pension providers and alienates those beneficiaries seeking to engage. We believe that this contributes to the disconnection of ordinary savers from the financial services system, ultimately damaging the system and its ability to meet consumer needs.

In addition to being required to answer beneficiaries' questions, pension providers, their asset managers and/or other intermediaries should be required to disclose details of assets held on customers' behalf and the 'churn' or turnover of those assets.

Disclosure of costs
We welcome the FCA's intention to consider whether there are markets where firms could be more transparent about the underlying value or performance of their products, in order to allow consumers (retail or wholesale) to better judge, either directly or via intermediaries, which product is appropriate for their needs. We believe that full disclosure of costs in wholesale markets would help pension funds and other investors secure best value. The approach developed in the Retail Distribution Review, whereby charges have to be agreed with clients, should be applied to wholesale markets, with a prohibition on authorised firms from generating income non-transparently based on knowledge of clients' business. Full disclosure of charges will promote effective competition, market integrity and will help achieve better outcomes for consumers whose monies are transacted in wholesale markets.

Concerns about excess of information

We note the comments made in the Discussion Paper and its associated literature review about the possible limitations on users' ability to process disclosed information and the problems associated with disclosing too much, or too complex, information. However, we do not believe that the disclosures proposed above would be subject to these problems.

The aim of our proposed disclosures is to help the industry create a culture of openness and trust in which savers can, if they wish, connect with the managers of their money. We propose that the majority of information should be made available on websites, preferably in a section dedicated to beneficiaries' information. The information will therefore be easily accessible for those who wish to search for it, without being part of the "noise" of information which consumers may experience at the point of sale. It should also be available on request, but again this will mean that individuals' are controlling their own consumption of the information.

We note the FCA's recognition of the conclusion from the FSA's DP08/3 that even if information is not used by many consumers, disclosure "*could still deliver benefits to consumers through better firm behaviour if the information was used by a minority of active consumers or other market participants*"[15]. It is important not to overlook the use to which information can be put by commentators, experts and consumer groups. For example, we ourselves use public disclosures to make comparative information available to the market in an accessible manner, through our benchmarking surveys and research reports. Thus, whilst a consumer may not choose to access the raw information, those working on their behalf can use it to alert consumers or regulators to good or bad practice in a way which is understandable and relevant.

[15] paragraph 2.16

Transparency of FCA regulation

Thematic reviews

In response to the questions raised after paragraph 4.18 in relation to the FCA developing a consistent approach for publishing the results of its thematic work, we think that the disclosure of such information would be helpful. In addition to the potential benefits identified in paragraph 4.18, we believe that the information would be useful for those working to monitor the financial services industry in the interests of consumers as it could allow them to see emerging trends in behaviour which may be of concern for consumers. For example, data reported by the Competition Commission revealed that the twelve largest distributors of payment protection insurance made profits that yielded a Return on Equity of 490%, clear evidence of market failure, ineffective competition, failure of consumer protection, and a source of excessive remuneration. The well-established approach adopted by the Competition Commission and the OFT to disclosure of economic and financial information in aggregated form should be adopted by the FCA.

How the FCA could be more transparent

We note the FCA's suggestions as to how it could be more transparent and we welcome the FCA's commitment to this area. As a civil society group operating outside the regulatory framework, we at times found it difficult to engage with the FSA. In particular, we propose the following areas for improvement:

- The FSA's consultation processes were often inaccessible and opaque. For example, Quarterly Consultations covered a wide variety of topics and were not actively publicised to relevant consumer groups. Small organisations like ourselves do not always have the time and resources to monitor and analyse papers to see whether relevant consultations are taking place, and their input may therefore be lost on topics where it would be relevant and valuable. It would be better if consultations are clearly distinguished by topic/theme on the FCA's website and pro-actively disseminated to external interested parties.
- More could be done to reach out to smaller and specialist consumer groups (for example the UK Shareholders Association, the Association of Member Nominated Trustees, and others representing the beneficiaries of particular types of financial services), for example by establishing working groups representing consumers in particular sectors, and by better publicising relevant consultations among consumer groups with a potential interest. The FCA should also reach out to a wider range of civil society organisations that may not be consumer groups in the traditional sense, but may have expertise on financial services issues with implications for consumers. Any such processes should be fully transparent and publicised through the FCA's website, rather than relying on organisations having personal contact with the FCA.
- The transparency of the teams within the FCA's organisational structure could be improved. It is very difficult for external parties to know which teams deal with which areas of work and to whom within those teams we should seek to engage. The FCA could improve this by publishing a clear and accessible organisational diagram with details of what each team does and the contact details of a person within each team who can deal with queries.

We welcome the suggestion by the FCA that it publish all responses to consultations (paragraph 3.12). There is a clear public interest in transparency regarding the representations made to the FCA by regulated entities and consumer groups. Publishing such information is already established practice for government departments.

We would welcome the opportunity to meet with you to discuss the above proposals.

Yours sincerely

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