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9th December 2015

Dear Sirs,

“Better Workplace Pensions: reducing regulatory burdens, minor regulation changes and response to consultation on the investment regulations”

ShareAction’s response to consultation questions 1, 11, 12 and 13

We would like to respond to the questions in the above consultation paper relating to reducing regulatory burdens (Q.1) and improving how information about investments is disclosed (Q. 11, 12 and 13). ShareAction is a registered charity established to promote transparency and responsible investment 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 35,000 individual supporters.

We are pleased that the Government is considering the issue of greater transparency in how people’s money is managed. In a debate in the last Parliament, Lord Bourne of Aberystwyth (Cons) noted that improved transparency (on wider issues than just costs) is a “vital” part of reforming pensions.

It is right that people should have access to clear, comprehensible information about how their money is invested, particularly when investing in DC schemes in which they bear all the investment risk. Giving such access enables and encourages people to take greater personal responsibility for their finances. Unfortunately, a lack of transparency is one factor which has contributed to market failings within the pensions sector, as acknowledged by the Office of Fair Trading’s 2013 review of the DC workplace pensions

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market, which found that the buy-side was “one of the weakest” it had analysed in recent years.\(^2\)

We expect that the Government will receive responses which state that people are not interested in requesting or receiving information about their pensions. This is not incorrect: automatic enrolment was introduced as a response to widespread inertia. But it would be wrong to rely entirely on existing evidence of members’ appetite for information as an argument for not changing the status quo. There is a severe lack of understanding in UK society about how pensions work. Furthermore, as we will explain, the information members do receive under existing rules often presupposes a much higher level of understanding or is vague and unclear. It is not surprising that people are not asking for (further) information. However, instead of using this apparent lack of demand as evidence that people do not care, the Government could look at jurisdictions in which people have greater rights and capabilities to engage with their pensions, rights which go beyond the release of basic information on request, for example, the Danish pension system. Evidence shows that these systems have better outcomes for members: the Danish system has been ranked as the best in the world for several years by the well-respected Melbourne Mercer Global Pension Index.\(^3\)

As a final general point, we would like to stress that any changes that are made by the Government to trust-based schemes should be replicated for contract-based schemes, as the legal structure of a pension scheme should not be a barrier to a member accessing information.

**Consultation question 1: Do you have any views on ways that the regulatory burdens on occupational pension schemes (including managers and trustees) can be reduced without compromising member protection?**

We would like to draw your attention to ShareAction’s recent research: Realigning Interests, Reducing Regulation (2015 Report). This research looks at the issue of over-regulation in the UK pension sector and argues that by focusing regulatory efforts on ensuring that schemes are well-governed, the need for piecemeal and frequent corrective regulation is reduced. It draws on evidence from a variety of jurisdictions with much better performing pension sectors.

In particular, we would like to draw your attention to the following sections (appended to this response):

- the **executive summary** (pages 2-6);
- our **recommendations** for what policymakers could do to foster a regulatory environment in which governance structures exist to promote best outcomes for members (page 7); and
  - the **conclusions** (page 46).

We note the Government’s desire, stated in Chapter 2, paragraph 1 of the consultation, to “make life easier” for pension schemes. As argued in the above report, there is a role for thoughtful regulation addressed at creating well-governed schemes that operate in the best interests of members. Such regulation would be worth implementing even if it did not “make life easier” for those managing schemes because it is, of course, the outcomes for


\(^3\) Australian Centre for Financial Studies and Mercer, ‘The Melbourne Mercer Global Pension Index 2014,’ 2014
members, the everyday savers, which matter. We do, however, believe that reduced regulation targeting key governance issues would also make life easier for scheme managers and trustees.

We would welcome clarification from the Government, in its response to this consultation, that it seeks to “make life easier” for pension schemes in order to improve outcomes for savers and pensioners.

**Consultation question 11: To what extent do trustees and scheme managers currently make information on selection, monitoring, retention, stewardship and realisation of investments; and selection, appointment and monitoring of investment managers and other agents available to beneficiaries on request?**

ShareAction undertakes regular surveys of the pensions sector and looks at the information made available to members. For example, in 2013/14 we surveyed the UK’s largest occupational pension funds and are in process of surveying the largest automatic enrolment providers and master-trusts. We also regularly create “email tools” enabling savers to email their pension funds directly to request information on various issues. Through these practical exercises, we have gained insight into how funds share information.

As noted in the consultation paper, The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (the “Regulations”) require trustees and managers to disclose certain categories of information. In our experience, the issue is not whether or not trustees comply with these provisions, but what compliance means in practice.

Before addressing the way in which disclosures are made, we would like to flag the role of disclosure of information in a low-regulation environment. We think it is important that refined state regulation is supplemented with effective participation by – and accountability to – beneficiaries, enabling them to take more responsibility for holding schemes to account. A prerequisite for this accountability is disclosure of relevant information. Where the state seeks to clarify regulation of a sector, like pensions, it is important that it assumes responsibility to set market conditions and to oversee providers. The ultimate risk of not doing this correctly is that members may seek redress from the government when private pension providers fail.

The Regulations require the disclosure by trustees or scheme managers of principles, policies or approaches to issues. In practice, this translates into funds publishing statements which are often very general, at times vague and “boilerplate”. In our experience, when members approach funds to ask questions about how their money is used in practice, they are directed to these statements. A typical example taken from the SIP of one of the UK’s largest funds is:

> The Trustee's policy is that the extent to which social, environmental or ethical considerations are taken into account in these decisions is left to the discretion of its internal investment manager, and external managers where appropriate. However, the Trustee expects that the extent to which social, environmental or ethical issues may have a fundamental impact on the portfolio will be taken into account by the investment managers in the exercise of their delegated duties.

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Obligations and rights attached to investments are strictly enforced for the benefit of the Fund. The Fund acts to maintain shareholder rights, and engages with companies as appropriate to protect or enhance its investments. Where applicable to external managers, the Trustee's policy is to delegate responsibility for the exercising of rights (including voting rights) attaching to investments to the investment managers and to encourage the managers to exercise those rights.

Whilst these statements may comply with the legal requirements to disclose the fund’s policies (if any) on voting and on SEE considerations, it is difficult to see what a member would learn from such disclosures. This point applies similarly to the other requirements in the Regulations to disclose the names of advisers. Another typical example from a large fund’s SIP is set out below:

The Trustee ...[has] delegated all day-to-day decisions about the investments that fall within each mandate to the relevant fund manager through a written contract. These duties include:

... Taking into account social, environmental, and ethical considerations in the selection, retention and realisation of investments in so far as this is consistent with their overall objectives.

... The Trustee...expect[s] the fund managers to manage the assets delegated to them under the terms of their respective contracts and to give effect to the principles in this statement so far as is reasonably practical.

It is difficult to see how a responsible individual could use this information to make informed decisions and to ask meaningful questions of a scheme. The issue that needs to be addressed is not whether funds disclose this information, but whether it is disclosed in a way which is meaningful to members. In our experience, this is not generally the case.

In our most recent review of the largest UK occupational funds, we found the following in relation to disclosure of equity holdings and the actual exercise of voting rights:

- 38% made no disclosure of their equity or other holdings.
- 25% only disclosed 5 to 10 of their largest equity holdings (a very small proportion of their portfolios), whilst 29% disclosed 100 or more equity holdings.
- 42% disclosed no information about how their shares were voted at company AGMs, with 21% providing only basic summary statistics.

Furthermore, the holding and voting of shares is only a small element of the potential influence pension funds have over investments in their portfolios. Far more important is the wider stewardship of investments, which includes engagement with managers of investee companies / entities in relation to (among other matters) corporate governance and corporate actions. Practice on disclosure of stewardship activities is varied – with just under half of the largest funds disclosing detailed stewardship and engagement reports. However, amongst smaller funds, very little meaningful information is available. This is despite the fact that stewardship was recognised as important by the Law Commission, which stated that trustees “should be encouraged to consider whether and how to engage with companies to promote their long-term success, either directly or through their investment managers” (para. 5.98 of the Law Commission’s 2014 review).
**Our recommendations**
The existing requirements for disclosures in the Regulations only go so far. They do not necessarily catalyse disclosure of meaningful information in a manner comprehensible to the average member. To improve this, the Government should consider requiring pension funds to undertake the following:

- Disclose policies on stewardship and engagement activities, in addition to voting.
- For the disclosure of any policies set out in legislation, trustees must explain why, if they do not have the policy, this is appropriate.
- Where the trustees’ policies amount to delegation to managers or other agents, they should be required to explain how they ensure that the policies are followed and how they monitor agents.
- Trustees should be required to report on the implementation of their policies annually (for example in the annual investment report). This would go some way to ensuring that trustees elaborate on the boilerplate statements in their SIPS and other policies in a way which demonstrates how these are influencing practices.
- At the very least, SIPS and annual reports should be published as a matter of course on the fund’s website.

The Government should:
- Require The Pensions Regulator to publish guidance on best practice for disclosing information to members, focusing on disclosing useful information in a way a layperson can understand. The Pensions Regulator should consult widely ahead of publishing this guidance.

**Consultation question 12: What are the challenges trustees and scheme managers might face in accessing this information including how it may be affected by different investment approaches?**

It would be of concern if pension trustees and managers were not able to access information about the selection, monitoring, retention and realisation of their investments; the stewardship of their investments or how they select, appoint and monitor agents to whom they delegate powers. This would be a serious governance failing, as this information is key to their oversight of investments.

Furthermore, asset managers should be making this information available under their mandates, UK Stewardship Code disclosures or equivalent policies required under the FCA's Conduct of Business rules.

However, we recognise that some arrangements between asset managers and trustees may make it more challenging to access information regarding where the money is invested and how it is being stewarded. In our 2013 survey of asset managers used by a group of institutional charitable investors, we found that the control enjoyed by clients invested in pooled funds was more limited than in segregated funds. However, this means that, when invested in pooled funds, it is even more important that trustees have robust policies and practices around setting mandates for managers and monitoring them. If trustees are not

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able to easily access information about where their money is invested, they must be able to show that they are exercising careful oversight of the way in which managers operate in pooled funds. If trustees genuinely cannot access information about these funds, this raises questions about whether or not it is appropriate for them to be investing members’ money in this way.

Similarly, it may be assumed that it is harder for trustees and managers to access information when invested in passive or tracker funds. It may also be assumed that it is harder for them to exercise voting and stewardship when in passive investments. However, trustees invested in trackers will have visibility on the indices being tracked and are able to exercise voting rights. It is also important that they have rigorous policies and practices on selecting and monitoring managers and on stewardship – if they cannot easily exit an investee company, it is even more important that they operate as responsible stewards. Such policies and reports on implementation should be easily available for trustees to disclose.

It may be that confidentiality is raised as a barrier to disclosure. Whilst some areas of managers’ mandates and some stewardship activities will genuinely be covered by commercial confidentiality, it is wrong to use this as a “blanket” excuse to disclosure. Redaction, delayed or partial disclosure should be possible.

**Consultation question 13: Do you have any information on the costs involved in disclosing this information to beneficiaries where such information is requested?**

As we have flagged above, all of the information in question should be available to trustees or scheme managers. It is the type of information they should have in their policies or should receive from their managers. Some pension funds already disclose this information proactively, so it can be done (for example, BBC Pension Trust Ltd). We suspect that costs are most likely to be higher where funds have not previously taken this information seriously and thus would need to work from scratch to produce it. However, we suggest that the easiest thing to do would be to require funds to have this information on their website. Most requests could then be directed to the website, with no further cost apart from updating. However, if the Government is concerned about additional costs, it could add a provision that further disclosure is not required where to do so would be unreasonably costly.

We also note that, if the principle is to release information on request, where people make the argument that members are not interested in this information, a lack of requests should ensure that there are no additional costs.
Executive Summary

Regulatory policy has given little attention to issues of market structure and the nature and effectiveness of competition, instead developing detailed and often prescriptive rules governing market conduct, with substantial cost and limited success. Regulation should focus on the establishment of market structures which provide appropriate incentives, rather than the fruitless attempt to control behaviour in the face of inappropriate commercial incentives.¹

Professor John Kay, 'The Kay Review of UK Equity Markets and Long-Term Decision Making'

The problem of poor saver outcomes in UK pension plans
This report asks if UK policymakers are making the right interventions in the area of workplace pensions in order to improve outcomes for the millions of savers whose retirement security is at stake. At present, there is evidence that system is not working as well as it should be for savers. The Office of Fair Trading’s 2013 report into the workplace pensions market unequivocally concluded that competition is not working effectively in this market, and found that fees and charges are often high, impossible to compare and frequently cancel out any investment returns.² A government-backed independent audit of contract-based providers found that up to £25.8 billion of savers’ money is trapped in schemes with unacceptably high charges.³ Also Better Finance EU reported that from 2000-2012 the average real annual return delivered to UK savers in workplace pensions was negative, at -0.7%.⁴

If outcomes are defined more widely than just fees, charges and annual investment returns to also include trust, accountability and Responsible Investment, the UK pension system must still be judged as underperforming. Responsible Investment (RI), an investment approach which takes account of environmental, social and corporate governance (ESG) factors in the belief that they are often financially material, particularly over the long term, is gaining mainstream acceptance.⁵ Pension schemes are by definition long-term savings products, but the governing boards of schemes often select and assess asset managers based on short-term performance data and have been slow to adopt RI. This focus on short-term metrics has been found to damage returns⁶ and many see it as contributing to the 2008 financial crisis. Perhaps unsurprisingly, trust in the pensions sector is very low, and distrust is the most powerful driver for people opting out of auto-enrolment.⁷

The evolution of UK pension provision over recent decades has seen more and more risks and costs pass from the state and employers onto the shoulders of individual pension savers. In 1979, final salary defined benefit (DB) pension funds comprised 92% of all workplace pension funds, meaning pension fund beneficiaries were guaranteed an income throughout retirement linked to their final salary.⁸ However most provision in today’s auto-enrolment era will be Defined Contribution (DC). This means savers’ incomes in retirement depend on contribution levels, investment performance, and fees and charges: there are no guarantees. Yet communications to and rights for savers have not yet adapted to the new reality that they are the main risk bearers.⁹ Furthermore, although studies report that consumers care about what financial services institutions are doing with their savings,¹⁰ it is difficult for pension scheme beneficiaries to find out how their money is invested or to hold their provider to account.

Communications to and rights for savers have not yet adapted to the new reality that they are the main risk bearers.
Bovenber, L., Mehikopf R., and Nijman, T.
Business and governance models in workplace pensions have been overlooked
The idea of the ‘paradox of privatisation’ describes how as the state seeks to minimise its financial responsibilities for pensions by encouraging private saving, it then must assume a greater responsibility to set market conditions and oversee providers. If private pension providers fail, savers may well seek redress from the government, as the Equitable Life affair shows. Savers have received £1.5 billion in compensation from the government so far and a European Parliament led inquiry judged that ‘regulatory failure was a major contributory factor’ in Equitable Life’s losses and ultimate failure.

Following the logic of the Kay Review that detailed regulation is costly, often ineffective and that promoting appropriate market structures is a better solution, this report set out to find whether some business and governance models in workplace pension provision deliver better results for beneficiaries. Our research finds that there may be less need for detailed regulation and regulatory oversight in the context of the workplace pension system where business and governance models achieve strong alignment of interests between beneficiaries and the people who run and govern the pension schemes. UK policymakers have recently begun to pay more attention to the topic of governance. However, given the significance of governance for performance demonstrated by our research, we do not believe that sufficient attention has yet been given to this topic or to the question of whether some business models may be fundamentally inappropriate for delivering workplace pensions and protecting beneficiaries who bear most of the risks in the automatic enrolment era.

The Research
This report examines the pension systems of Australia, the Netherlands, and Denmark, widely recognised as amongst the best in the world, alongside the different types of scheme available in the UK. Literature was examined from a variety of sources in addition to data on returns and charges of different models. Interviews were conducted with individuals with a variety of relevant expertise and experiences in the pension sector and we held a roundtable event to discuss our main research question.

The differences in business models examined include whether schemes are trust, contract or master-trust based; how scheme governance is structured and how it functions; the scale of pension schemes; the extent to which key functions are carried out internally or outsourced; and whether the business model is for-profit or not. The research finds that well governed pension schemes have the following features:

- motivation and alignment of interests of key parties, including beneficiaries; scheme boards; scheme executives; asset managers; and employers
- independence and diversity of decision makers on boards
- board members and supporting staff with suitable skills, knowledge and resources
- accountability and transparency of board decision making
- appropriate and clearly defined allocation of powers and responsibilities within the scheme and throughout the investment chain.

Lessons from overseas on pension scheme governance and business models
In Australia, not-for-profit ‘industry’ pension schemes, where trustees are appointed by employers, beneficiaries or unions, have outperformed their for-profit ‘retail’ counterparts, where trustees are appointed by commercial providers or via executive search. The not-for-profit funds delivered on average 2.4% higher real returns over the last decade than their for-profit counterparts. The not-for-profit industry funds also seem to be leading the way on innovative and RI strategies. For example, 30 industry funds established their own asset management company, IFM, due to dissatisfaction with the services available on the market. As these not-for-profit pension funds own IFM investment, decisions can be taken with a longer term view and in beneficiaries’ enlightened best interests, according to IFM and the funds who use them.

The Danish Pension system has been judged to be the best in the world, with the lowest costs and according to Better Finance EU delivered real average annual returns of +4.7% over a 12 year period where UK savers received -0.7%. There are 3 business model typs for workplace pensions in Denmark. Firstly, multi-employer saver owned funds, similar to master trusts, established via collective bargaining and with saver and union elected trustees. Secondly non-commercial life-insurance companies also established via
collective bargaining and owned by sectional unions with boards composed of employer and union representatives and the company’s employees. Thirdly, for organisations not covered by industry or sector wide collective agreements there are commercial life insurance companies where scheme beneficiaries elect trustees at AGMs and company employees are also represented on the board. According to some commentators, the well enshrined participation rights of employers, beneficiaries and unions in Danish pension governance means that less detailed regulation is required. Another defining feature is that most investment management is conducted in-house.

The Dutch pension system is similar to the Danish in that workplace pensions are either provided for through not-for-profit pension funds, which can be single company or industry wide, or via contracts with commercial insurance companies. The OECD judges the Dutch system to have the third lowest costs out of 40 countries examined. Our research suggests that one reason for this is the culture of Dutch boards who seem to negotiate harder on fees and charges than British ones. Board structures in the Netherlands are bi- or tri-partite with functions of accountability, management and scrutiny clearly separated.

Following the 2008 Financial Crisis, many Dutch schemes suffered heavy losses and public trust was undermined. Regulators have responded with a package of reforms including a strong focus on governance. Stricter diversity requirements have been introduced for pension fund and insurance company boards which require age and gender diversity alongside the established role for stakeholder groups (beneficiaries, deferred beneficiaries, unions and pensioners) on pension fund boards. The new Code of the Dutch Pension Funds states:

‘When representatives of various groups are involved in the process, a multi-dimensional perspective can be achieved, which is of benefit to the decision-making process… To perform optimally, a board requires a range of skills cultures and views’.

In the Netherlands including representatives of different age groups was seen as crucial for restoring public faith in the intergenerational fairness of the system, and a similar justification was given for the diversity requirements on insurance company boards.

In addition to including stakeholders in governance structures, Dutch not-for-profit pension funds are also more likely to consult with the wider membership base than the commercial insurance companies, for example through open AGMs, surveys, and public meetings around the country to discuss policy. Comparing benchmarking studies by the Dutch Association of Investors for Sustainable Development (VBDO) reveals that pension funds outperform the insurance companies on virtually every RI measure as well as doing more to communicate with members.

Scheme size matters to beneficiary outcomes
Our research also identified that the size of a pension scheme is a strong indicator of good outcomes for beneficiaries. Schemes must operate at scale to ensure adequately skilled governing bodies, sufficient internal support and to access economies of scale and better bargaining power. Costs per sever can be brought down when there are more beneficiaries in a scheme to bear them. The other countries examined have more numbers of large schemes compared with the UK.

Scale does not guarantee RI will be pursued, but bigger schemes consistently take it more seriously. One recent study of RI by UK pension funds found that ‘smaller funds find it more difficult to fully consider ESG issues due to lack of time, resources and in some cases understanding.’

In the UK the data shows bigger schemes performing better for beneficiaries. However the UK is unlike the other countries examined because nothing has been done at a policy level to encourage or require consolidation of
small schemes. In Australia, schemes have to report to the regulator annually on whether insufficient scale in terms of beneficiaries or assets means the financial interests of their beneficiaries are compromised compared to the beneficiaries of bigger schemes. As a result of this surge the number of schemes fell from 5,000 in the mid-1990s to 500 by the end of 2009 and the average scheme size in Australia is 26,000 beneficiaries compared with 2,500 beneficiaries in the UK. UK policymakers should intervene on this issue as market forces will not drive consolidation at sufficient speed.

**Poor governance and inappropriate business models are detrimental for beneficiaries**

The research found that misaligned interests between savers and those running and governing pension schemes appear to be a significant cause of saver detriment, and such misalignments derive from a pension scheme’s business and governance model. Some business and governance models do seem to perform consistently better than others, for example according to one major study, annual returns net of fees are superior for trust based (or similar) schemes as opposed to contract-based ones in the USA, Canada and Australia.

Our research identified a variety of business model and governance features which are significant for saver outcomes. It is difficult to isolate the effects of these different variables and determine which is most important causally. In the countries examined not-for-profit schemes are also more likely to include stakeholder representation in governance; and they are subject to different legal duties towards beneficiaries in the case of the UK and Netherlands. What is clear is that more representative, diverse governance arrangements, less shareholder owned businesses and a smaller number of large schemes are a defining feature of the Dutch and Danish systems and the best performing model in Australia. The research indicates that no single feature is enough on its own. There must be a package of positive business model and governance features in order to achieve the right organisational culture and good outcomes for savers.

Another important variable is whether pension schemes outsource investment management or conduct it in-house. Outsourcing is meant to benefit beneficiaries through providing access to a wider range of skills and investment opportunities and thus portfolio diversification. Yet this research corroborated a key message of the Kay Review, namely that heavily intermediated investment chains are often detrimental for end beneficiaries. Outsourcing does seem to be a significant cause of misaligned incentives and interests, in particular by driving short-term investment horizons.

There has been an increase in institutional investors bringing investment management back in-house following the 2008 financial crisis. However this is a challenging process that must be done with care. In order to realise the benefits such as better alignment of interests between principals and agents, higher net-of-fee investment returns and more sustainably constructed portfolios, the systems, processes and human capital of the pension scheme need overhauling. This must be underpinned by strong governance.

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**UK business and governance models do not serve pension savers well**

Out of the business and governance model types available in the UK, large, single employer trusts best exemplify the ideal characteristics identified but are a priori not an option for the thousands of small and medium sized employers in the UK now entering the auto-enrolment system. Although the master-trust model has the potential to deliver these benefits to smaller employers, this potential has not been realised as the governance arrangements in master trusts do not exhibit best practice. There are troubling conflicts of interest in the business models of some master-trusts, particularly where commercial insurance companies have established a master trust and handpicked the trustees.

The Collective Defined Contribution model is also unlikely to achieve the good saver outcomes hoped for if scheme governance is not considered with more care, and attention given to the Dutch and Danish governance models which
apparently provide the inspiration for this type of scheme. Contract-based schemes least exhibit the good business and governance model features identified.

In the UK there has been a tendency to blame the poor performance of some schemes on the presence of member nominated trustees from outside the financial services industry. The fact that there is no requirement for member nominated representatives on master-trust trustee boards or on the newly established Independent Governance Committees at contract-based providers certainly suggests that policymakers do not have faith in the capabilities and value of member nominated representatives. However the research did not find evidence that the poor performance of some schemes is due to the presence of lay trustees or representatives. Lack of scale, expensive investment management fees and poor oversight of outsourced arrangements seem to be the main causes of saver detriment.

The research did not find evidence that the poor performance of some schemes is due to the presence of lay trustees or representatives. Lack of scale, expensive investment management fees and poor oversight of outsourced arrangements seem to be the main causes of saver detriment.

Conclusions
We hope that this report and the recommendations made will catalyse a genuine debate and more consideration from UK policymakers as to the importance of business models and governance in workplace pension schemes. The findings strongly suggest that getting the business models and governance right can reduce the need for ever more detailed regulations and codes of conduct which regulators lack the capacity to oversee compliance with. The findings also imply that any attempts by UK policymakers to copy more successful pension scheme outcomes found overseas, for example Collective Defined Contribution schemes, are unlikely to achieve the desired results if the full range of business and governance model features driving those good outcomes are not adopted here.

The evidence from abroad and from large single employer trusts in the UK suggests that lay trustees can be effective if they are given training, sufficient time to fulfil their duties and adequate support from internal staff. Expectations of trustees must be realistic considering they meet 3 or 4 times per year; even if they are investment experts they cannot conduct detailed scrutiny of service providers or day-to-day management. The research identified that benefits of including saver, union or employer representatives on boards who are not finance industry experts can include: a healthier culture on the board, and an openness to challenge service providers in beneficiaries’ best interests; true independence from scheme or service providers; and trust of the wider membership.
Recommendations

A number of recommendations to policymakers are made throughout this report. They are summarised below.

- The governing structures of all schemes should include representatives of beneficiary groups. Beneficiaries should be able to elect representatives and put themselves forward for such positions.
- Training for beneficiaries on governance boards should be compulsory. The training should be designed to give candidates the confidence and ability to ask challenging questions.
- In the DC world, employers have less motivation to make sure schemes are working well than in DB where they bear risk. Therefore in any given workplace senior management should be obliged to place a significant portion of any pension contribution from their employer in the same scheme as the rest of the workforce to align interests and provide motivation for senior management to scrutinise the scheme.
- Policymakers should monitor and publish figures on the diversity of the governing boards of automatic-enrolment compliant pension schemes.
- In addition to including beneficiaries in the governance structure, all schemes should adopt mechanisms to communicate with the membership as a whole and ascertain their views. Positively, regulations have recently been introduced in the UK for some schemes to do this. The government should advise on best practice in relation to this.
- All those responsible for governing and running pension schemes, including those responsible for investment management should be subject to fiduciary standards and to duties requiring them to act in the best interest of savers, including prioritising savers’ interests above those of other stakeholders where conflicts of interests exist.
- Amend the Employment Rights Act 1996 so that Member Nominated Trustees or member representatives in other types of pension schemes have the same rights to request reasonable time off work to fulfil their duties as magistrates, school governors, trade unionists, beneficiaries of the Army Reserve forces and other roles prescribed in the legislation.
- Policymakers should take action to drive economies of scale in DC pension schemes rather than waiting for market forces to have an effect, as the potential for market forces to drive scale particularly in small single employer trusts is questionable. Trustees could be required to demonstrate that a lack of scale is not disadvantaging beneficiaries. If they cannot, the schemes or fund should be required to merge with another, as is the case in Australia.
- The duties of Independent Governance Committees should be amended to include scrutiny of the providers’ policies and practices on stewardship of investee companies and its consideration of environmental, social and corporate governance risks.

Note on terminology

In this report we use the term “saver” or “beneficiary” to refer to individuals with savings in all different types of workplace pension scheme. The term “pension scheme” is used as to refer to all the different business models and governance models that can be used to deliver workplace pension schemes, although it should be noted that large providers such as insurance companies deliver multiple schemes.
Conclusion

Towards Good Outcomes in the UK

Our research suggests that the failure of the UK’s workplace pension system to consistently deliver good outcomes for beneficiaries is linked to unsatisfactory business and governance models in pension provision. Attempts to use ever more detailed regulation of scheme activities to address the problem of poor outcomes for savers are likely to fail. Furthermore the cost of complying with regulation is inevitably passed on to beneficiaries. Although UK policymakers have recently begun to consider good governance and look at the best performing pension models from overseas, we are not convinced that enough attention has yet been paid to the governance and business models of pension provision that are needed in the automatic enrolment era to protect beneficiaries and deliver long-term public policy objectives. In a DC environment beneficiaries bear all the investment risk but communications to beneficiaries have not evolved to reflect this and nor have savers’ rights to information.

An exemplary pension scheme would ensure a strong alignment of interests between beneficiaries and those running and governing the scheme. This can be achieved by including saver representatives on governance a body with genuine powers and applying legal duties to prioritise savers’ interests to all individuals responsible for overseeing the scheme. A diverse balance of experts and stakeholder representatives is most likely to deliver good outcomes for beneficiaries as a balanced board can achieve the independence and diversity of views necessary for effective scrutiny and debate. Training can be mandated, and possibly provided, by regulators to help ensure all beneficiaries of governing committees are capable. To ensure that governance is effective, there must be a clear distinction between day-to-day management, responsibility for the scheme overall, and responsibility for scrutinising internal and external managers.

The research also finds that pension schemes must operate at scale to deliver value for money. The Australian and Dutch experiences show that action from policymakers can be very effective at driving consolidation and is certainly more efficient than waiting for market forces. Finally, the research also indicates that no single business model or governance feature is enough on its own. There must be a package of positive business and governance model features in order to achieve the right organisational cultures and good outcomes for savers.

The analysis of the business and governance model types available in the UK found that they currently do not serve savers well. Large, single employer trusts best exemplify the ideal business and governance model features but are a priori not an option for the thousands of small and medium sized employers in the UK who need a scheme in which to automatically enrol their employees. Although the master-trust model has the potential to deliver the benefits of a large, single employer trust to smaller employers, this potential has not been realised as trustee boards only need to have 3 members who can all be selected by the provider and none need to be stakeholder representatives. The Collective Defined Contribution model is also unlikely to achieve the good saver outcomes hoped for if governance is not considered with more care, and attention given to the Dutch and Danish templates. Contract-based schemes provided by commercial insurance companies were the least satisfactory model.

The question of whether the for-profit business model is appropriate for delivering workplace pensions also merits further consideration by policymakers. The benefits of market-based competition do not appear to outweigh the disadvantages in terms of marketing and sales costs and the introduction of misaligned incentives. What is more, competition cannot be expected to function properly when savers cannot choose their workplace pension provider. The fact that the UK now has master trusts delivered by non-for-profit and by for-profit providers means that there is an opportunity to isolate this variable and compare performance more definitively in the next 3 to 5 years.

We hope that this report and the recommendations made will catalyse a genuine debate and more consideration from UK policymakers as to the importance of business and governance models to workplace pensions. Regulators lack the capacity to oversee ever more detailed regulations and codes of conduct and these measures have not resulted in good outcomes for beneficiaries. We believe that getting the business and governance models right can reduce the need for complex regulation and is a better driver of good outcomes.