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# **ShareAction's response to the House of Commons Work and Pensions Select Committee inquiry into progress with automatic enrolment and pension reforms**

## **Overview**

ShareAction (formerly FairPensions) 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.

## **Scheme Governance**

We share the concern raised in the conclusion of the Committee's 2013 report:

*'We are concerned about the potential for some people to be auto-enrolled into schemes with poor governance. Governance is a particular challenge for DC schemes, and it is this type of scheme that the vast majority of employees will be auto-enrolled into'* (p.48)

We applaud the government's efforts to raise standards in scheme governance and we welcome the decision to introduce governance committees (IGCs) within contract-based providers, something that ShareAction has called for since our 2012 report ['Whose Duty? Ensuring effective stewardship in contract-based pensions'](#) but we are concerned that the proposals for IGCs are inadequate and will not improve outcomes for all savers. IGC's will lack independence, will not ensure accountability of the provider to members themselves and their remit is too narrow. Alongside scrutinising the value for money of default funds, IGCs should also consider communications to members, administration, the performance of third party service providers, stewardship and the investment strategies for all funds offered.

The composition of IGC's and method of selecting who sits on them, namely two employees of the provider and three independent experts appointed by the provider, are not fit for purpose; these Committees will not be independent. Employers and members, or employer groups and trade unions, should be given a role in electing or selecting candidates to IGCs to ensure genuine independence from the provider. We do not think there is a valid reason for employees of the provider to sit on the IGC.

We are also concerned that governance standards for master-trusts are not sufficiently robust, and are subject to similar weaknesses to the proposed structure for IGCs. In its DC workplace pension market study, the OFT highlighted the risk 'that some trustee boards may not be sufficiently independent of the master trust provider to avoid potential conflicts of

interest'<sup>1</sup>. Trustee boards composed entirely of independent, professional trustees appointed by the provider and representatives from the provider itself will not be able to provide effective scrutiny of that same provider or may not be able to robustly challenge them when necessary. The Law Commission has also expressed this concern.<sup>2</sup>

We would like to bring it to the Committees attention that there are no requirements for member nominated representatives in either IGC's or master-trusts. Member nominated trustees (MNTs) have been performing a valuable role in pension governance over the last 20 years since the Robert Maxwell scandal exposed the need for broader stakeholder involvement in governance. Yet as more and more employers opt for contract or master-trust schemes instead of providing their own trust, MNTs could cease to be a feature of the UK's pension landscape.

The experience of MNTs on the boards of trust-based pension schemes shows that there are numerous benefits to including member representatives in pension scheme governance. The 1993 Goode Report into Pension Law Reform found that:

*'There are many reasons why it is desirable to have member trustees. They impose the discipline of another view, bringing to the trustee board a different experience and perspective, and helping to ensure that the interests and views of scheme members as potential beneficiaries are constantly kept in mind' (4.5.24)*

The report also concluded that fears relating to the competency of MNTs had been 'exaggerated' (4.5.20).

No one has produced evidence that the undoubted poor governance in some trust based schemes is due to the presence of member nominated trustees. The DWP<sup>3</sup>, TPR<sup>4</sup>, OFT<sup>5</sup> and this Committee<sup>6</sup> all say that lack of scale is the most common cause of governance deficiencies in trust-based schemes. In contrast it is clear that for-profit pensions operating in what the OFT has found to be a non-functioning market have routinely over-charged and provided a poor deal for consumers.

A central theme of the Kay Review is that properly aligned incentives between savers and those managing their money are essential to ensuring that money is managed in savers' best interests. Aligning interests through the presence on governing bodies of member representatives will be much more successful than 'seeking to counter inappropriate incentives through the elaboration of detailed codes of conduct'<sup>7</sup>. Member representatives, whose own retirement security depends on the performance of the pension scheme, have

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<sup>1</sup> OFT 'Defined contribution workplace pension market study', 2014,

<sup>2</sup> Law Commission consultation paper, 'Fiduciary Duties of Investment Intermediaries', 2013

<sup>3</sup> 1 DWP, Better workplace pensions: Further measures for savers', 2014

<sup>4</sup> 2 TPR, 'Ensuring good governance and administration in work-based defined contribution pension schemes', 2012 and TPR, Delivering successful AE. The Pensions Regulators Approach to the regulation of employers and schemes, 2012

<sup>5</sup> OFT 'Defined contribution workplace pension market study', 2014,

<sup>6</sup> paragraphs 29-30 of the 2012-13 report

<sup>7</sup> Kay, J., 'The Kay Review of UK Equity Markets and Long-Term Decision Making', Final Report, 2012, p.9

incentives that are *a priori* well aligned with other members' interests. They can also provide a valuable perspective on member communications.

ShareAction has 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, including MNTs. We have heard repeatedly that trustees who have worked for years in the financial services industry can be the least likely to challenge the status quo, particularly 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. However, a degree of knowledge and understanding is clearly required to carry out an effective role in pension scheme governance. It should be compulsory for trustees to complete the regulator's Trustee Toolkit and the FCA should provide similar training materials to enable candidates from outside the financial services industry to sit on IGCs.

The Australian Superannuation system provides evidence that representative governance models are more successful at protecting scheme members' interests than models where commercial 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. Only small proportions are appointed through executive search. 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>8</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 than the retail funds over the last decade.

Governing bodies need to have a range of skills and backgrounds that ensure they have both the expertise to run a pension scheme and the ability to understand and identify the member interest. The Government's own review of 'Women on Boards' in February 2011 led by Lord Davies of Abersoch concluded that

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<sup>8</sup> 'The Success of Representative Governance on Superannuation Boards, The McKell Institute, June 2014

‘it is clear that boards make better decisions where a range of voices, drawing on different life experiences, can be heard’.<sup>9</sup>

Yet prioritising the role of ‘independent experts’ in pension scheme governance over allowing stakeholders themselves to have a role, results in governing bodies severely lacking in diversity in terms of age, gender and professional background. In the FCA’s proposals for IGCs, they note that as firms expect to draw candidates from such a ‘limited pool’<sup>10</sup>, they have already requested that the definition of ‘independent be relaxed. This is very worrying.

The Committee’s 2012-13 report suggests that the government and regulators find ways to assist all employers to set up internal pension governance arrangements, but they ‘appreciate that setting up such committees may present a challenge for small and medium sized employers’ (paragraph 28). Giving employers and employees a role in electing or selecting who can sit on IGCs, including the ability for employer or employees to put themselves forward for these positions is a good compromise between involving these stakeholders but not burdening every employer with the requirement to set up a governance committee. Although employers should be encouraged to scrutinise pensions properly, it is not realistic to require all employers, especially small and micro ones who will soon enter the auto-enrolment process, to set up governance committees.

There needs to be a clear requirement to include member representatives in master-trusts and IGCs in the new quality standards. The government has failed to include this requirement and appears to have passed judgement on member representation without allowing for proper, public debate on this important issue.

### **Costs and Charges in DC Schemes**

ShareAction applauds the government’s action on costs and charges, however we recommend that the Committee reiterates its call in the 2012-13 report ‘that the Government carefully monitors the level of pension scheme charges’ (p.49). Even though some types of charges will be banned and the charge cap will come into force in April 2015, it must be noted that not all costs are included in the charge cap and only default funds are subject to the charge cap. It concerns us that members who choose a fund other than the default fund are more at risk of inappropriate charges.

DWP’s definition of what constitutes a cost versus a charge, as set out in their March 2014 Command paper, is useful and their assessment that transaction costs cannot be included in the charge cap as they cannot be predicted in advance is valid. However, transaction costs can be significant and need to be tackled alongside the important work that is being done to tackle more visible annual management charges. For example, Railpen Investments recently concluded an extensive review into transaction costs paid to their asset managers and found that these fees were around 300-400% of the upfront management fees they were paying.<sup>11</sup>

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<sup>9</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>10</sup> Paragraph 3.17

<sup>11</sup> ‘Railpen to reduce external managers over fee concerns’, Professional Pensions, 27/08/2014, available at <http://www.professionalpensions.com/professional-pensions/news/2362085/railpen->

Providers should be obliged to disclose the total actual costs and charges that are taken from a members' pot retrospectively in annual statements to members or at their request. Reporting and disclosure of these costs should be made in a standardised format and the FCA should provide leadership and guidance as to how to achieve this. The OFT's 2013 report goes into great detail about how the lack of common definitions for fees and charges impedes comparability and exacerbates the problems of asymmetries of information and the weak buyer side of this market.

### **Transparency and the effectiveness of self-regulation**

ShareAction echoes the concerns expressed in paragraph 9-10 of the conclusion of the Committee's 2012-13 report, and notes that sufficient progress has still not been made with regard to transaction costs. The regulator should issue clear, mandatory guidelines on how to disclose costs and charges, and also on how to assess value for money. The current proposals for IGCs from the FCA, for example, suggest that each provider develop its own framework that the IGC can use to judge the value for money of the scheme. There is a clear conflict of interest in allowing providers such a prominent role in designing the framework that they will be judged against. It would be more helpful for employers and savers if all schemes were judged against the same criteria, facilitating comparability.

### **Communications with Scheme Members**

In the context of the new freedoms that pension savers have been given with regard to their retirement savings in this year's budget it is more essential than ever that savers are provided with comprehensible and engaging information. However, communications from pension providers are focused on compliance, protecting the company from risk and making sure all the necessary facts are in the small print. They are not designed with the members in mind. Providing savers with information on where their money is invested and the role it plays in the real economy can be a valuable tool for engaging savers with their pensions. The rapid growth of the fossil fuel divestment movement, for example, shows how supposedly complex and inaccessible investment issues can catch the imagination of the public.

Although the written statements that providers send to members are important, and the Committee rightly recommends that they be improved (recommendation 15), it should be noted that communications must be a two way process. It is currently extremely difficult for scheme members to initiate communications with their schemes.

ShareAction has extensive experience of enabling pension scheme members to contact their schemes through our online campaign tools<sup>12</sup> to ask where and how their money is being invested. In the last year alone over 7,000 UK pension holders have emailed their fund through our tools. Unfortunately, many scheme members receive replies that are obfuscatory, unsatisfactory or no reply at all, which discourages further engagement. During a previous campaign, one provider took 3 years to reply to a member's email query.

Savers should be provided with contact details for any queries about their investments, and should have the right to receive a response to reasonable requests for information. Like

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[to-reduce-external-managers-over-fee-concerns](#)

<sup>12</sup> For example, <http://action.shareaction.org/page/content/greentlightlanding/>



listed companies, pension schemes should be required to hold annual general meetings giving savers an opportunity to scrutinise the board. The existence of such an annual forum would help build much-needed trust and confidence, even amongst members who do not attend. 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. As we detail in our 2013 report, 'Our Money, Our Business'<sup>13</sup>, even if only a small proportion of members engage with their pension provider, the scrutiny of a vocal minority helps improve outcomes for all members.

This year, ShareAction has also facilitated meetings between Aviva, The Pensions Trust and their respective scheme members. These providers, as well as Legal and General following their AGM, told us they found the experience of speaking to members directly incredibly valuable.

### **The regulation of workplace pensions**

We agree that treating customers fairly 'should be a matter of course' and is a 'low baseline' for the pensions industry to aim for. (p.50) The 'Treating Customers Fairly' regime has not proved to be sufficient to protect consumers of other financial products in the past, as shown by the payment protection mis-selling scandal for example.

The proposed 'duty to act in the interests of relevant scheme members' for IGC's is significantly weaker than the fiduciary duty which pension scheme trustees are subject to. The most robust way to protect members' interests is to impose a fiduciary duty on the individuals responsible for managing their savings, as acknowledged in paragraph 25 of the 2012-13 report . ShareAction has received legal advice that IGC members, unlike pension scheme trustees, cannot be given fiduciary obligations as they will not have the powers necessary to fulfil these obligations. We propose, therefore, that IGC's terms of reference should require the IGC members to prioritise members' interests over the interests of any other stakeholders and to resolve any conflict of interest should be resolved in the best interests of members. This is in line with Recommendation seven of the Kay review.

We would welcome the opportunity to input in more depth to this inquiry. We have undertaken extensive research into the pensions sector and we would be happy to share this with the Committee.

Yours sincerely,

Camilla de Ste Croix  
Senior Researcher

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<sup>13</sup> [http://www.shareaction.org/sites/default/files/uploaded\\_files/investorresources/OMOB.pdf](http://www.shareaction.org/sites/default/files/uploaded_files/investorresources/OMOB.pdf)