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NEST: Evolving for the Future

We would like to respond to the Department for Work and Pensions' consultation on the future of NEST. ShareAction is a registered charity established to promote transparency and Responsible Investment ("RI") 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. Our chosen automatic enrolment provider is NEST.

Do you agree these are the right principles to help Government weigh up proposals for changing NEST's policy framework?

We agree that the series of principles set out at paragraph 22 are good ones to help the Government weigh up these proposals. We set out some further comments on the application of the principles below.

Our starting position is that NEST can and should be tasked with playing an important leadership role for the pensions sector, establishing new norms and best practice, and testing new ideas.

Consumer focus

In relation to NEST's consumer focus, we believe that NEST's member panel is a positive feature of the scheme's arrangements that should be maintained. It has assisted NEST with taking member views and considerations into account. The panel essentially plays an advisory rather than a decision-making role, and we recommend that NEST now move to put members on the board of the scheme. This would mirror the historic governance structures of single employer trusts and give NEST greater legitimacy amongst its millions of members across the UK economy. Global best practice in pensions governance sees boards with a combination of highly skilled pensions experts and suitably qualified individuals with a direct stake and interest in the success of the scheme, as discussed in Keith Ambachsteer's recent book, *The Future of Pension Management: Integrating Design, Governance, and Investing*.¹

Now that NEST has over 3 million members, we are in no doubt that suitably qualified and skilled individuals could be identified amongst the membership to take a third of the positions on NEST's board. At a time when the government is looking to bring workers on to the

¹ Ambachsteer, K. (2016.) *The Future of Pension Management: Integrating Design, Governance, and Investing*. Hoboken: Wiley.

boards of companies it is an anomaly that member representation is disappearing from British pension schemes whose core obligation is to act in the best interests of scheme members. We see a strong argument for maintaining the principle that one third of the members of a pension scheme board be comprised of individuals whose own retirement assets are invested by the scheme. We would like to see NEST show leadership in this important aspect of scheme governance, with support from DWP.

In line with normal practice in the corporate sector and amongst a growing number of pension schemes, we would encourage NEST to hold an Annual Member Meeting (AMM), to be webcast for the benefit of those unable or unwilling to travel to the meeting. A recording of the AMM should be made available on NEST's website each year. This would allow the more engaged members of NEST to hear a presentation from trustees and senior executives about how the scheme has managed their retirement assets over the previous year, and what plans the scheme has to deliver strategy and manage risk into the future on behalf of members. The Pensions Regulator's guidance accompanying its new DC Code² highlights AMMs as one way that multi-employer schemes can stay close to members and focused on their perspectives. We would like to see NEST adopt this leading practice.

ShareAction undertakes regular surveys of the pensions sector and looks at the information made available to members. For example, we have surveyed the UK's largest occupational pension funds³ and the largest automatic enrolment providers and master-trusts.⁴ We also regularly create email tools enabling savers to email their pension schemes directly to request information on responsible investment issues. Through these approaches, we have gained insight into how funds share information. Across the market as a whole, there is significant room for improvement. Positively, NEST seems committed to developing and improving its own disclosures, and we commend in particular the recent publication by NEST of its first Responsible Investment report.

It is important that NEST shows itself to be an exemplar scheme by championing transparency and excellent communication as a key element of delivering value to savers and building trust in pensions. Quite understandably, given its young age as a scheme, NEST continues to be some way short of global best practice in its governance arrangements and reporting. We hope to see NEST catch up with the global leaders in the next five years, with support and encouragement in this from DWP.

Inclusiveness

The principle of inclusiveness is an important one, particularly as NEST's membership is younger and has lower earnings than most other schemes in the UK. The millennial generation is often characterised in pensions commentary as disinterested in pensions and disengaged with its financial future. This is not wholly surprising, given that recent research from the Resolution Foundation⁵ indicates that a typical millennial has earned £8,000 less during their 20s than a typical person in the previous generation. Indeed, the research suggests that millennials may be the first ever generation to face a generational pay penalty

² Pensions Regulator. (2016.) *Communicating and reporting*. Available online at: <http://www.thepensionsregulator.gov.uk/trustees/communicating-with-members-in-your-dc-scheme.aspx> [accessed 5 October 2016].

³ ShareAction (November 2014.) *Entrusted With Our Future: A survey of the Responsible Investment performance of UK pension funds*. Available online at: <http://shareaction.org/wp-content/uploads/2016/03/EntrustedWithOurFuture.pdf> [accessed 5 October 2016].

⁴ ShareAction. (March 2016.) *Reclaiming Ownership: A survey of governance and responsible investment at UK automatic-enrolment pension providers*. Available online at: <http://shareaction.org/wp-content/uploads/2016/03/UKPensionsSurvey2015.pdf> [accessed 5 October 2016].

⁵ Resolution Foundation. (July 2016.) *Stagnation Generation: The case for renewing the intergenerational contract*. Available online at: <http://www.resolutionfoundation.org/wp-content/uploads/2016/07/Intergenerational-Commission-launch-document-1.pdf> [accessed 5 October 2016].

by earning less than their predecessors over the course of their working lives. For those who are finding it harder to make ends meet at the present time, future financial concerns are inevitably less of a pressing concern, and more proximate issues take precedence.

However, a recent Morgan Stanley study found that compared to the overall individual investor population, millennials are nearly twice as likely to invest in companies or funds that target specific social or environmental outcomes.⁶ Aime Williams recently argued in the *Financial Times* that fund managers are missing a trick in failing to offer tailored ethical and responsible pension investment options for the younger generation, saying: “People of all ages need better options so that investing feels like something interesting and worth doing. ‘If you don’t pay attention to your pension you’ll regret it when you’re old’ is not a very compelling threat to make. ‘If you don’t pay attention to your pension you’re going to screw up the world’ is far more likely to elicit a response.”⁷ Hawksmoor Investment Management recently announced that it is to launch an ethical portfolio service for its clients next year, citing an increase in the number of clients, particularly of the younger generation, who said that ethical considerations were a key aspect for them when investing.⁸

To engage younger savers, NEST should explore ways of offering and communicating options that allow them to align their investments with their interests and values, without compromise to either cost or risk-adjusted returns. Given its scale, we think this is something that NEST could focus harder on in the next five years.

Value for money

NEST should make all efforts to research and understand the charges levied by its suppliers, and ensure that its members get the best value for money possible. This is not the same as the lowest possible costs, and NEST should feel confident in justifying investment costs that deliver real benefit over the long-term to its scheme members.

A lack of costs 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 market, which found that the buy-side was “one of the weakest” it had analysed in recent years.⁹ NEST should aspire to lead the pack amongst private pension schemes in making investment and scheme costs visible. The Dutch pensions market has made particular progress in this regard, and we would expect NEST to meet the standards of the best Dutch pension schemes.

Bearing in mind the principles set out on page 11: Should NEST be able to develop and offer a range of decumulation services for its members? What would be the impact on individuals, employers, NEST and other pension providers of this approach?

We believe that NEST should look at offering a range of decumulation services for its members. NEST should be encouraged to demonstrate genuine innovation if it is allowed to develop these services, creating ‘pathfinder’ products to test the market. We believe that this

⁶ Morgan Stanley. (February 2015.) *Sustainable Signals: The Individual Investor Perspective*. Available online at: https://www.morganstanley.com/sustainableinvesting/pdf/Sustainable_Signals.pdf [accessed 5 October 2016].

⁷ Williams, A. (September 2016.): “Why does pension investing have to be a moral dilemma?”. *The Financial Times*. Available online at: <https://www.ft.com/content/8fbf7dce-768d-11e6-bf48-b372cdb1043a> [accessed 5 October 2016].

⁸ Dew, L. (October 2016.) “Hawksmoor plans to bring ethical portfolio service to market”. *Investment Week*. Available online at: <http://www.investmentweek.co.uk/investment-week/news/2473006/hawksmoor-plans-to-bring-ethical-portfolio-service-to-market> [accessed 5 October 2016].

⁹ OFT (September 2013, revised February 2014), *Defined contribution workplace pension market study*. Available online at: <http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/OFTwork/markets-work/pensions/>. Last accessed 29 January 2016

would help to raise standards across the board. NEST should extend its thinking on responsible investment to the provision of decumulation services.

We are aware of proposals that NEST should be allowed to create 'merged products' that provide an income decided by NEST. This additional responsibility would strengthen the case for member representation on the board.

Bearing in mind the principles set out on page 11: Once automatic enrolment has fully rolled out, should access to NEST be more flexible? What would be the impact on individuals, employers, NEST and other pension providers of this approach?

We believe that access to NEST should be more flexible. Contractual enrolment in, bulk transfers and individual transfer of pots to NEST should all be allowed. As recognised in this consultation paper, members benefit from schemes operating at scale. Scale can ensure that schemes have adequately skilled governing bodies, sufficient internal support, and can access economies of scale and better bargaining power. Costs per saver can be brought down when there are more beneficiaries in a scheme to bear them.

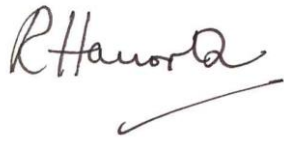
NEST's scale is a good thing. Nevertheless, we are concerned that the auto-enrolment landscape is developing in a lopsided manner. NEST is rapidly becoming one of the largest pensions schemes in the world but, on the other hand, there are too many sub-scale and inefficient AE providers, some with problematic commercial conflicts of interest that undermine member outcomes. We would like to see a better balanced market, with DWP pursuing a strategy that drives the market to create a modest number, perhaps 10, multi-employer defined contribution schemes that each operate on the scale required to achieve outcomes for savers that compare with the best performing pension schemes across the world. Each such scheme could have an obligation to take on employers and savers that choose it, in other words sharing the burden and responsibility of NEST's universal service obligation in return for lifting some of the restrictions that currently apply to NEST. The aim should be a more level playing field between a small group of high performing, large DC schemes with best-in-class governance arrangements that put members' interests first.

Pension savers enrolled in a pension scheme selected by their employer should be free to choose a different one without risk of losing their employer's contributions. This would drive real consumer-led competition in the market, something which does not currently exist. Clearly, many employers could find it challenging to deal with multiple pension providers so DWP should look at supporting a clearing house service which accepts contributions from employers and allocates them to the appropriate pension provider.

There is a connected point in relation to the high-cost legacy schemes recently uncovered by providers' independent governance committees (IGCs). We understand that IGCs are currently in something of a quandary, as it is important that the savers in those high-cost schemes are transferred out, perhaps to NEST, but they are currently unable to do so without being seen to give advice. A public consultation is currently underway on the implementation of the Markets in Financial Instruments Directive II, and this looks at the exemption from authorisation for "Article 3 firms" providing advice (those who do not hold client funds or securities; only receive and transmit client orders in relation to transferable securities and/or provide related investment advice; and do not do business outside of their home member state). This consultation may provide an opportunity to resolve this issue.

We would be happy to meet to discuss any of the views raised.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'R Haworth'. The signature is written in a cursive style with a long, sweeping underline that extends to the right.

Rachel Haworth, Policy Officer