



***Response to the DWP Consultation Paper
Re
Pension Scheme Disclosure***

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Response of FairPensions to the DWP Consultation Paper Re Pension Scheme Disclosure

1. About FairPensions

FairPensions is pleased to have this opportunity to comment on the consultation paper “Review of Disclosure of Information Requirements applying to Occupational, Personal & Stakeholder Pension Schemes” published by the Department for Work and Pensions (“The Consultation Paper”).

FairPensions is the operating name of Fairshare Educational Foundation, a registered charity¹ that aims to persuade UK pension funds and fund managers to adopt an effective responsible investment (“RI”) capability and to monitor and manage environmental, social and governance (“ESG”) risks.

RI requires the integration of ESG considerations into investment policy. For this purpose, investment policy includes engagement with investee companies i.e. shareholder activism through dialogue, reinforced by the potential exercise of shareholder powers.

FairPensions believes that RI practices help to safeguard investments, as well as securing environmental and social benefits.

FairPensions is supported by a number of leading charities and trade unions, including ActionAid, CAFOD, Community, CWU, ECCR, EIRIS, GMB, NUJ, Oxfam, Traidcraft, Unison, Unite and WWF. We are also supported by almost 5,000 individuals.

Further information about FairPensions and about our approach to RI can be found on our website.²

2. Executive Summary

(i) An effective disclosure regime is essential to ensuring that the principles of transparency and accountability are given practical effect in pension scheme governance.

(ii) This applies in particular to responsible investment, as without adequate disclosure neither scheme members nor the wider public can monitor investment and engagement policies or their implementation.

(iii) Responsible investment furthers the interests of pension scheme beneficiaries and also those of society, as it fosters financial stability and ecological sustainability. This public interest dimension underpins the case for regulation, if that is needed to secure adequate disclosure in this respect.

(iv) Following the failure of the lightly regulated financial system, there should no longer be a presumption in favour of deregulation; instead, the approach to any potential regulation should be evidence-based, with each case considered on its merits.

(v) There is evidence, including FairPensions' own research, that the average level of disclosure in relation to pension scheme investments falls far below the required standard and that this is at least in part attributable to insufficient regulation. Accordingly, we think that the current regulations should be strengthened and we are therefore opposed to their being replaced with an even looser, “principles-based” alternative.

¹ Registered charity number 1117244

² www.fairpensions.org

(vi) Moreover, the Government's proposal to combine prescriptive disclosure regulations that relate to the IORP Directive and to certain other matters with a generally non-prescriptive approach based on a single overarching principle is likely to give rise to unnecessary complications, including uncertainties about whether the Directive has been properly implemented.

(vii) We think, however, that it could be helpful if strengthened disclosure regulations incorporated an overarching principle that provided guidance on their interpretation and application. The particular overarching principle suggested in the Consultation Paper is, however, deficient, because it relates only to individual benefits and does not recognize the key role that disclosure should play in promoting better scheme governance, including responsible investment. Suggested wording for such a wider principle is set out at the end of this Executive Summary.

(viii) We favour a consistent approach to disclosure across all categories of pension schemes, while recognizing that some variations will remain in view of schemes' different structures.

(ix) We strongly disagree with the suggestion in the Consultation Paper that the present regulations in relation to pension schemes' annual reports "should be deregulated as far as possible". On the contrary, we consider that these regulations need updating and strengthening in several respects. In particular, the requirements pertaining to the scheme's investment report should be extended in the ways set out in this Response.

(x) We do not agree with the proposal to remove the specific time limits for meeting the disclosure requirements and to replace these with a general provision for compliance within a reasonable period. We believe that this would disadvantage members seeking to protect their individual interests or to monitor the administration of their schemes.

(xi) In general, we favour greater use of electronic communication for disclosure. In particular, we think that the new disclosure regulations should provide for specified information to be posted on scheme websites. This information should include the scheme's annual reports, which would contain the additional material outlined in this Response. This would enable disclosure of such information to be automatic, rather than on request.

Suggested Wider Overarching Principle

"Members individually should be given sufficient and timely information that allows them to understand the benefits to which they will be entitled and any other relevant information that will enable each member to make decisions in his or her own best interests. In addition, each scheme should observe the principle of transparency and should make available to members collectively all the information that they need to assess the scheme's administration and investment."

3. Scope of this Response

This Response concentrates on those aspects of disclosure that relate to RI. We would, however, emphasise that ***many of the points made in the Response apply with equal force to pension schemes' administration and investments generally.*** For example, the concern of responsible investors that corporate policy be aligned with the long-term interests of the enterprise has obvious implications for executive remuneration, not least in preventing compensation from being structured so as to reward short-term profits rather than sustainable ones. ***Almost everyone now recognizes that corporate governance failures in this and other respects contributed to the***

current financial crisis and that institutional investors bear some of the blame because they acquiesced in such practices. It is therefore essential to ensure more responsible shareholder oversight in future.

This Response covers (i) the importance of effective disclosure to the protection of members' interests and to the promotion of good scheme governance in general, as well as of RI in particular, (ii) the financial and legal reasons for pension schemes to pursue RI policies, (iii) the public interest dimension of RI, in relation both to the economy and to the environment, and (iv) our replies to the specific questions asked in the Consultation Paper, in so far as these have relevance to RI.

4. The Role of Disclosure in Scheme Governance

As the OECD Guidelines for the Protection of the Rights of Members and Beneficiaries state,

“Adequate disclosure, in addition to helping to effectuate the substantive and procedural rights of members and beneficiaries, may also lead to more effective pension plan governance by enabling members to monitor certain aspects of plan administration”³

The function of disclosure is therefore not limited to giving members details about their individual benefits and options, essential though that is: **it also extends to the provision of sufficient information to members to allow them to monitor all aspects of scheme administration that affect their interests, including costs and investment performance.**

Full and public disclosure about the running of the scheme is essential for the following reasons: firstly, so that members can know what is happening in the administration of their scheme and, if necessary, can exert pressure on their trustees to improve their performance; secondly, so that scheme trustees and members can compare their scheme's standards of disclosure against best practice among their peers; and, thirdly, so that the public, who have a legitimate interest in the many of the activities of pension schemes, have access to relevant information.

These considerations are clearly relevant to information about schemes' RI policies and about how such policies are applied in practice. For example, disclosure of the specific investments of the scheme is the easiest way for members to see whether any investment gives rise to questions, either about what action the scheme has taken in relation to known issues of corporate behaviour or about whether the investment should be held at all. Likewise, voting records and other engagement activities are usually not of a highly technical nature and can therefore be easily understood by beneficiaries; at the same time, unless specific details are supplied, beneficiaries cannot check that the engagement policy has been observed.

Integral to our campaign for RI, therefore, is our demand for greater **transparency** on the part of occupational pension scheme trustees in reporting to their beneficiaries on their RI policies and on the implementation of those policies. We also wish to see equivalent transparency in relation to personal and stakeholder pension schemes.

Full disclosure of schemes' investment and engagement policies and of the execution of those policies is thus central to the promotion of RI. The regulations that govern such disclosure are therefore of the utmost importance in this context.

5. The Financial and Legal Case for RI

Institutional investors increasingly recognize that RI policies can contribute to financial return. The growing number of asset owners, investment managers and investment consultants

³ www.oecd.org/daf/pensions/guidelines

who subscribe to the United Nations Principles for Responsible Investment is evidence of the emerging consensus about the financial importance of ESG factors.⁴ As the introduction to the UNPRI puts it:

“As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios”.

Recent research also supports the view that shareholder engagement can increase investment returns beyond traditional benchmarks. We would refer, for example, to the review of key academic and broker research on ESG factors which was co-authored by the Asset Management Working Group of UNEP FI⁵ and Mercer.⁶ The review included four academic studies of shareholder activism on governance issues; of these, three found a positive effect on investment return, the fourth being neutral.

One of these studies is particularly noteworthy: it examined activism by CalPERS (California Public Employees Retirement System), the largest public pension plan in the US and a leading activist fund. The study concluded that, over the period under review, the value increase of CalPERS' holdings from activism was almost US\$19m, compared to estimated costs of activism of approximately US\$3.5m.⁷

In parallel with the new thinking on this subject within the investment community, ***there has been an increased acceptance among lawyers that pension funds should take ESG considerations into account when determining investment policies.*** For example, the international law firm Freshfields Bruckhaus Deringer produced a report⁸ for UNEP FI on the law in nine separate jurisdictions⁹ regarding the integration of ESG issues into investment policy. The report concluded that

*“...the links between ESG factors and financial performance are increasingly being recognised. On that basis, integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions”.*¹⁰

As well as this financial significance of ESG factors, the report considered the question of whether pension schemes should take into account their beneficiaries' non-financial concerns over ESG issues, provided this did not prejudice investment performance; it concluded that

*“It is also arguable that ESG considerations must be integrated into an investment decision where a consensus (express or in certain circumstances implied) among the beneficiaries mandates a particular investment strategy and may be integrated into an investment decision where a decision-maker is required to decide between a number of value-neutral alternatives”.*¹¹

In this connection, and in a most significant development, the Government has recently confirmed in Parliament that

“There is no reason in law why trustees cannot consider social and moral criteria in addition to

⁴ See the list of signatories at www.unpri.org/signatories/

⁵ The United Nations Environment Programme Finance Initiative, www.unepfi.org

⁶ *“Demystifying Responsible Investment Performance: A review of key academic and broker research on ESG factors”* UNEP FI / Mercer, 2007
www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf.

⁷ *ibid*, p.32

⁸ Freshfields Bruckhaus Deringer *“A legal framework for the integration of environmental, social and governance issues into institutional investment”*, 2005(www.unepfi.org/fileadmin/documents/freshfields_legal_resp_2005123.pdf).

⁹ namely, Australia, Canada, France, Germany, Italy, Japan, Spain, the UK, and the US.

¹⁰ Freshfields Bruckhaus Deringer *op cit* p.13

¹¹ *Ibid*

their usual criteria of financial returns, security and diversification. This applies to the trustees of all pension schemes”¹².

Both the financial and the ethical dimensions of RI are therefore now well established.

6. The Public Interest Case for RI

Once it is accepted that RI can increase long-term financial returns, it is clearly in the financial interests of pension scheme beneficiaries for their funds to practise RI, just as it is in their non-financial interests for the investment policies to reflect their ethical values.

It also follows that there is a broader public interest involved: if RI contributes to the more efficient allocation and the more prudent management of investment capital, it is of benefit to the wider economy. As already mentioned, there is now a general acceptance that irresponsible and unaccountable corporate behaviour of the kind that brought the global financial system to the brink of collapse and plunged the world economy into recession can no longer be accepted; the principles that underpin RI can provide the basis for a new model of responsible, fiduciary capitalism.

There is, however, an even more important public interest dimension to RI. Socially irresponsible corporate conduct is one of the main sources of the environmental problems threatening the global economy and society. ***The promotion of corporate social responsibility by institutional investors should therefore be a public policy imperative not only in the economic but also in the environmental sphere.***

Perhaps the most obvious example of the environmental significance of corporate behaviour is its causal role in climate change. There is growing awareness among institutional investors that climate change has become a fiduciary issue.¹³ One manifestation of this is the Institutional Investors Group on Climate Change, whose membership now comprises European pension funds and other investors with aggregate assets under management of some four trillion euro. The IIGCC has pointed out that

“institutional investors have a critical role to play in supporting the move to a low carbon economy through using their influence as major shareholders and bondholders in the world's companies and as substantial investors in other assets such as property as well as using their influence with policymakers”¹⁴

As the above statement indicates, there is a twofold aspect to the development of RI: although much depends upon the initiatives taken by investors, ***there is also a need for governments to provide a legal and regulatory framework which encourages and supports RI. For the reasons already explained, disclosure regulations should be a key component of any such framework.***

7. Replies to Consultation Questions

Consultation question 1

“Against the background that a streamlined set of prescriptive provisions would still be required for the purposes of satisfying IORP and in the interests of certainty for schemes, do you support the addition to the legislation of a key, overarching disclosure principle?”

¹² Lord McKenzie of Luton, House of Lords, *Hansard* 7 October 2008, Column 181

¹³ See, for example, “*A Climate for Change*” (2005), produced by Mercer Investment Consulting for the Institutional Investors Group on Climate Change and the Carbon Trust (www.iigcc.org)

¹⁴ “*Investor Statement on Climate Change Report 2007*” p.7, (www.iigcc.org)

We think that several distinct points arise here:

(1) The presumption in favour of deregulation

The general thrust of the Consultation Paper is to bring about more deregulation. This approach carries forward the original programme of the Government's Deregulatory Review, most recently reflected in the Independent Report of July 2007 and the Government's Response of December 2007.

We find it surprising that the Consultation Paper appears to have taken no account of the intervening implosion of the *laissez faire* financial system and of the resulting reassessment of the supposed virtues of "light touch" regulation. This is quite different from the approach taken in the Turner Review, published in the same month, which has announced "more intrusive and more systemic" regulation by the FSA.¹⁵

The explanation for this difference may be that ***the Consultation Paper takes a particularly narrow view of the function of disclosure and, in particular, shows no appreciation of its potential relevance to the role of pension schemes as major institutional shareholders with the capacity to influence the governance of their investee companies in the direction of stability and sustainability.*** In other words, it fails to take a "systemic" approach. For the reasons already set out in this Response, however, it is essential that this aspect of disclosure be accorded its due importance.

In our view, therefore, the basic assumptions underpinning the Consultation Paper have been overtaken by events, to the extent that the very concept of a "Deregulatory Review" of pension schemes is now an anachronism.

We are not suggesting regulation for its own sake, merely that there should no longer be a universal presumption in favour of deregulation, based on a doctrinaire, and now discredited, market fundamentalism. Instead, potential regulations should be considered pragmatically, on a case-by-case basis. Such cost / benefit analyses should take into account the advantages that the regulation in question could have not only for the individual scheme but also for the financial system as a whole; again, we have particularly in mind here the encouragement of responsible investment and engagement policies.

In this context, FairPensions has just published its latest research on RI: *Responsible Pensions? UK Occupational Pension Schemes' Responsible Investment Performance 2009 ("our RI Performance Review")*.¹⁶ The findings of this report confirmed those of a transparency survey that we carried out in 2007 in one interesting respect: the marked contrast between the transparency standards of local authority pension funds and those in the banking sector. In both surveys, even the lowest-rated local authority fund significantly outperformed the highest-rated bank scheme in transparency.

As stated in our RI Performance Review,

"We believe the disparity stems from a combination of government regulation and the interplay between transparency and improved policy and practice. Each survey that FairPensions has conducted, whether it has focused on pension schemes or fund managers, has shown a consistent link between investment transparency and higher standards of RI.

As public institutions and major recipients of public funding, local authority pension schemes are required by law to provide a high level of public disclosure regarding their pension funds. We

¹⁵ www.fsa.gov.uk/pubs/other/turner_review.pdf see especially pages 86 to 93.

¹⁶ The Review is on our website, www.fairpensions.org

believe this transparency requirement encourages enhanced attention to policy detail, implementation and performance measurement.”¹⁷

Thus there is evidence that stricter disclosure regulation improves transparency. We suggest that this is hardly a surprising conclusion.

(2) Combining reduced “prescriptive” provisions with an overarching disclosure principle

As a preliminary point, we think that “*prescriptive*” should not necessarily be seen as a pejorative term, although it seems to carry that connotation in the Consultation Paper and in earlier documents prepared for the Deregulatory Review. The now exposed weaknesses of a notably non-prescriptive financial system might suggest that prescription can have its uses.

Paragraph 25 of the Consultation Paper recognises that a principles-based approach has the disadvantages of uncertainty as to compliance with its principles and of lack of clarity as to members' rights; Paragraph 26 acknowledges that in any event there will have to be prescriptive regulations to give effect to IORP. Despite this, Paragraph 27 records that

“The working group felt that, even within this constraint, introducing a high level principle that trustees should take into account members' best interests when providing them with information provided an opportunity to reduce the level of prescription in the current disclosure provisions, without disrupting schemes' current arrangements”.

Paragraph 29 goes on to state:

“We believe it is necessary to specify disclosure requirements where:

- *the information is required by IORP, or*
- *the information is about a member's benefits; key events in the membership life cycle; or the status of the scheme”*

We find it hard to follow the reasoning here, especially as such a hybrid system seems likely to give rise to extra complications, not least in ensuring that all the requirements of IORP are met.

To take just one example of the kind of difficulties which we foresee, Paragraph 38 of Annex C to the Consultation Paper envisions that current regulatory requirements in respect of schemes' annual reports “*should be deregulated as far as possible so that schemes are left to decide what should be included in the report. However some prescribed items are IORP requirements – eg the availability of the annual accounts – and these will have to be retained”* .

The specific IORP requirement referred to is presumably that in Article 11, Paragraph 2 of the Directive, which provides:

“Members and beneficiaries and/or, where applicable, their representatives shall receive:

(a) on request, the annual accounts and the annual reports referred to in Article 10.....”.

This requirement, however, has no bearing on the **contents** of the accounts and reports that are required under Article 10. Article 10 is not among the provisions of IORP that are reproduced in Annex B to the Consultation Paper, so for ease of reference we set it out here:

“Annual accounts and annual reports

Each Member State shall require that every institution located in its territory draw up annual

¹⁷ Page 11

accounts and annual reports taking into account each pension scheme operated by the institution and, where applicable, annual accounts and annual reports for each pension scheme. The annual accounts and the reports shall give a true and fair representation of the institution's assets, liabilities and financial position. The annual accounts and information in the reports shall be consistent, comprehensive, fairly presented and duly approved by authorised persons, according to national law”.

It is hard to see how a regime under which “*schemes are left to decide what should be included in the report*” can be said to comply with Article 10. For instance, how could this ensure that the accounts and reports are “*consistent*” or “*comprehensive*”?

Recital (22) of IORP (which is reproduced in Annex B) states that the annual accounts and reports “*are an essential source of information for members and beneficiaries of a scheme*”.

As our primary concern is schemes' investment activities, we would refer too to Recital (23), which states:

“Proper information for members and beneficiaries of a pension scheme is crucial. This is of particular relevance for information concerningthe investment policy....”

and also to Recital (24) which states:

“The investment policy of an institution is a decisive factor for both security and affordability of occupational pensions....”

and which then refers to the need to draw up a statement of investment principles and to make this available to members and beneficiaries.

Both the wide wording of Article 10 and the importance that the Directive gives to the annual accounts and reports in general and to information about investment policy in particular ***strengthen the case for a wholly, rather than partially, prescriptive approach in this regard. This would be simpler and clearer than the hybrid alternative and be more likely to ensure compliance with IORP.*** We think that this is also true in respect of the disclosure regime generally.

We also believe that there is a need to make radical changes to the existing disclosure requirements in relation to scheme investments, that there is a public policy case for these changes to apply generally and that they therefore need to be prescriptive. These matters are covered below, in our reply to consultation question 3.

(3) An alternative approach: an overarching principle as part of fully “prescriptive” regulations

Although, for the reasons given above, we do not agree with the idea of an overarching principle that would facilitate a move towards more principles-based regulation, we think that there could be advantages if more specific disclosure regulations incorporated a general principle to which, in the words of paragraph 1 of Annex C to the Consultation Paper,

“schemes must have regard in determining their disclosure arrangements and in interpreting the regulations themselves”.

Such a principle could encourage trustees to adopt the spirit as well as the letter of the regulations and might reduce the ever-present danger of mere “box-ticking” compliance.

We would therefore be inclined to favour the concept of a overarching principle, provided this was not part of a general shift towards principles-based regulation. We would not, however, support the adoption of the particular principle suggested in the Consultation Paper, unless it were broadened in the way described in paragraph (4) below.

(4) The need for a wider overarching principle

We believe that the overarching principle proposed in the Consultation Paper is deficient in an important respect. The principle, as set out in paragraph 1 of Annex C reads:

“Members should be given sufficient information that allows them to understand the benefits to which they will be entitled and any other relevant information that will enable each member to make decisions in his or her own best interests.”

We have no quarrel with what the principle says: our concern is with what it does not say. The principle does not recognize the rights of members to know how their scheme is being administered and, in particular, how it is invested and how it is exercising its rights as an institutional shareholder. (This includes what the scheme's fund managers are doing in this respect.) As we have already explained, this is important for the following reasons:

(i) so that members' interests are served by being able to monitor their schemes' investment and engagement policies, both in relation to their long-term financial interests and to their ethical concerns; and

(ii) so that the public interest is served by schemes' being more likely to promote responsible and sustainable behaviour in investee companies.

We would therefore suggest that the overarching principle be broadened to read as follows (with amendments shown by underlining):

“Members individually should be given sufficient and timely information that allows them to understand the benefits to which they will be entitled and any other relevant information that will enable each member to make decisions in his or her own best interests. In addition, each scheme should observe the principle of transparency and should make available to members collectively all the information that they need to assess the scheme's administration and investment.”

We would make the following comments on the above wording:

(i) We envisage that the regulations would stipulate that information relating to individual members' benefits would normally be provided by email or post whereas more general information about the scheme's administration and investment would normally be posted on a scheme website. (See also our comments in reply to consultation question 6.) The wording therefore makes an explicit distinction between these individual and collective means of communication.

(ii) We have had the benefit of seeing the response that the Occupational Pensioners' Alliance has made to the Consultation Paper. We agree with their suggestion that the principle should refer to “sufficient and timely information”. (See also our comments in reply to consultation question 4.)

(iii) Although it is not essential to the structure of the widened principle, we have included a reference to the principle of transparency. As this principle is already enshrined in the Myners principles (Principle 6, *Transparency and reporting*), scheme trustees should be thoroughly familiar with it. Clearly, there would be no question of transparency extending to confidential details relating to individual members; these would in any case fall under the first limb of the overarching principle. If, however, it were thought necessary, this point could be explicitly covered in the regulations. The same could apply to any commercially sensitive issues connected with the scheme's investment policy.

Consultation question 2

“Do you support the consolidation of general disclosure provisions into one set of regulations, rather than the existing position where disclosure requirements affecting occupational, personal and stakeholder schemes are dealt with separately?”

From an RI perspective, disclosure of investment and engagement policies, and of their implementation, should be of the same standard in both occupational and personal schemes. This is particularly important in view of the continuing shift from trust-based occupational schemes to contract-based personal schemes. For group personal pension schemes made available by employers, the disclosure procedures could well be quite similar to those for trust schemes;¹⁸ for purely individual arrangements, the focus will probably need to be more on the scheme providers. As the section on disclosure in the recently revised draft OECD Guidelines on Governance of Pension Funds observes:

“In the case of pension funds that support personal pension arrangements , certain information....may need to be disclosed to the public at large via appropriate mechanisms (e.g. websites and printed media)”.

Accordingly, we favour a consistent approach to disclosure in relation to all kinds of pension schemes. The idea of a single set of regulations would be consistent with this principle, although we have no strong views on what we see as essentially a drafting question. The more important point is that the regulations should be comprehensible as well as comprehensive.

Consultation question 3

“Do you consider the proposed approach outlined in Annex C is appropriate? Detailed comments on particular requirements would of course be welcome.”

We have already explained why we do not agree with the general approach outlined in Annex 3. We shall therefore deal here with some particular requirements (adopting the headings and paragraph numbers of Annex C, except where otherwise stated):

Basic Information about the scheme

Paragraphs 13 & 14

The Consultation Paper gives no details of which of the 29 separate requirements in Schedule 1 to The Occupational Pension Schemes (Disclosure of Information) Regulations 1996¹⁹ (*“the 1996 Regulations”*) it is proposed to dispense with, as not being required by IORP, but almost all of them seem to relate to *“the rights and obligations of the parties involved in the pension scheme”*, and therefore to fall within Article 9(f)(i) of the Directive. It is therefore not clear to us quite what scope for simplification there is here.

Paragraph 16

This paragraph assumes that the provision of information about members' investment options would be governed by the general, overarching principle. Article 11, Paragraph 4 of the Directive, however, specifically provides that

“Each member shall also receive, on request, detailed and substantial information on:

.....

¹⁸ N.B. Currently, *“wholly-insured”* trust schemes do not have to include in their SIPs a policy statement on RI (among other matters) (regulation 8, The Occupational Pension Schemes (Investment) Regulations 2005, SI 2005/3378) but we are assuming here that this category of scheme will also be covered under the envisaged unified approach.

¹⁹ SI 1996/1655

(c) where the member bears the investment risk, the range of investment options, if applicable, and the actual investment portfolio as well as information on risk exposure and costs related to investment”

Indeed, Paragraph 36 refers to this requirement. We do not, therefore, understand quite what the overarching principle would add here. This is another example of the problem, inherent in the proposed hybrid system, to which we have already referred in our reply to consultation question 1.

Information to be made available to individuals

From the comparison table in Annex D, it appears that most of the existing regulatory requirements in this respect will remain unchanged. Moreover, these particular provisions have generally little relevance to RI.

In view of this, we have only one comment to make; this relates to the suggestion in Paragraph 37 that where an independent trustee has been appointed to a scheme, it should no longer be a requirement that when members are notified of this event they are also notified of the scale of fees that will be chargeable by the trustee and payable by the scheme. We note that the table in Annex D describes this change as the regulation being “*simplified*”, but since there will still be a requirement to send out notification of the trustee's appointment there would appear to be no appreciable cost saving.

It is hard to see any justification for this proposal. When members are increasingly exercised about the effect of administrative costs on their ultimate benefits and when pension schemes are under growing pressure to demand transparency from their investee companies over remuneration issues, it would be inconsistent for trustees to become less forthcoming about their own charges.

Although this is a relatively minor provision, it is perhaps indicative of a more general failure in the Consultation Paper to appreciate the need to furnish members with the information that they need in order to monitor the professionals acting on their behalf. We think that this failure would have been less likely had the working group included some representatives of scheme beneficiaries alongside the organisations from the pensions industry.²⁰ We believe that there should always be member representation in such circumstances.

Annual Report

Paragraph 38

In our reply to consultation question 1 we have already referred to the proposal in Paragraph 38 that the requirement in the current regulations to prepare an annual report “*should be deregulated as far as possible so that schemes are left to decide what should be included in the report*” and to the general difficulty that could arise in ensuring that IORP was complied with in this regard. ***Here we wish to comment on specific provisions in Schedule 3 to the 1996 Regulations that we consider should in any event be retained, and in many cases strengthened, whether or not these are considered to be mandated by IORP.***

As elsewhere in this Response, our comments are mainly confined to provisions relating to scheme investments. We should, however, make it clear that this ought not to be taken to imply that we approve of the deregulation of the other provisions. On the contrary, our general view is that there should be full disclosure to members to enable them to protect and enforce their rights and to monitor all aspects of their scheme's administration.

Before dealing with individual provisions, we wish to make the general point that under the current regulations a copy of the annual report has to be furnished members only on request, with the

²⁰ Consultation Paper, page 6, footnote 3

trustees being allowed two months to comply with any such request.²¹ **We believe that regulation should shift from a reactive to a proactive basis and that the annual report, including the investment report, should be made available to members as a matter of course.** We think that this should normally be achieved through electronic means, and in particular through a scheme website, and we shall therefore deal with this topic in more detail in our reply to consultation question 6.

We turn now to specific paragraphs of Schedule 3 to the 1996 Regulations:

Schedule 3, Paragraph 11

“Who has managed the investments of the scheme during the year and the extent of any delegation of this function by the trustees”

It should not need saying that scheme members must be told who are managing their fund and on what terms (including as to remuneration). So far as RI is concerned, the annual report should also disclose details of **the integration of RI policy into fund manager selection and into Investment Management Agreements.** These points should be covered in the scheme's investment report, which is dealt with below, in relation to Paragraph 14 of Schedule 3.

Schedule 3, Paragraph 12

“Whether the trustees have produced a statement of the principles governing decisions about investments for the purposes of the scheme.....and where the trustees have produced such a statement, advising that a copy is available on request.”

This is a wholly inadequate provision, not least because the trustees are then given a further two months after any such request to provide a supply a copy of the SIP.²² **The full SIP should be set out in the annual report,** as part of the investment report.

Schedule 3, Paragraph 13

“Except in relation to a wholly insured scheme, a statement as to the trustees' policy on the custody of the scheme assets.”

This statement should be required to address the specific measures taken to minimize risk to the scheme. It should also disclose the trustees' policy on stock-lending. So far as practicable, the specific custodians employed should be identified. Again, this should form part of the investment report.

Schedule 3, Paragraph 14

This paragraph requires any scheme which is obliged to have a statement of investment principles to include in its annual report an **investment report** containing:

“(a) a statement by the trustees, or the fund manager, providing details of any investments made for the scheme during the year which were not made in accordance with the statement of investment principles governing decisions about investments required under section 35 of the 1995 Act;

(b) where investments for the scheme have been made in the year which do not accord with the statement of principles governing decisions about investments required under section 35 of the 1995 Act (or were made in a previous scheme year and continued to be held at the end of the year), a statement by the trustees, or the fund manager, giving the reasons why and explaining

²¹ Regulation 6(3) & (4) of the 1996 Regulations

²² Regulation 7(3) of the 1996 Regulations

what action, if any, it is proposed to take or has already been taken to remedy the position;
(c) a review of the investment performance of the scheme's fund-
 () during the year; and
 () [broadly, during the previous 5 years],
including an assessment of the nature, disposition, marketability, security and valuation of the scheme's assets.”

In our view it is imperative that any future regulations retain a requirement for an investment report. It is essential that members be kept informed about the status of their fund, including its performance and security. At a time when billions of pounds of pension fund value have been lost and when there is a pervasive lack of confidence in the financial system, any retreat from transparency in this respect would be especially deplorable.

Moreover, **this provision needs to be strengthened and updated** in the following respects:

(i) When the disclosure regulations were made in 1996, the present wording was sufficient to catch any departures from the SIP, as **all the required contents of the SIP**, as specified in section 35 of the Pensions Act 1995 (as originally enacted), **related ultimately to the making of investments and not to the exercise of rights (including voting rights) attaching to them.**

(ii) With effect from 3rd July 2000, however, trustees have had to state in their SIPs

“their policy (if any) in relation to the rights (including voting rights) attaching to investments”.²³

As, however, there was no consequential amendment to the disclosure regulations, these failed to catch any departures from policy in this regard.

(iii) There is, in our view, a further problem in that the disclosure regulations refer only to investments which were not “made” in accordance with the SIP. Since 3rd July 2000, however, trustees have also had to state in their SIPs

*“the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments”*²⁴

It could well be that the original selection of an investment was made in accordance with the trustees’ RI policy but that subsequently its retention becomes inconsistent with it. This might be because of a change relating to the investment (e.g. where the scheme was tracking a socially responsible index, such as one of the FTSE4Good indices, and the investment ceased to qualify for inclusion in the index). Alternatively, it might be because of a change in the policy. It is less likely that the realisation of an investment would be contrary to an RI policy but this is not inconceivable. Revised regulations, therefore, should explicitly cover departures from the policy on the selection, retention and realisation of investments.

Just by way of illustration, in order to cover both the above points the existing paragraphs (a) and (b), quoted above, could perhaps be amalgamated and amended as follows:

“(a) a statement by the trustees, or the fund manager, of any departures during the year from the statement of principles governing decisions about investments required under section 35 of the 1995 Act, giving details of the investments involved and an explanation of the reasons and what action, if any, is proposed to be taken or has already been taken to remedy the position. The statement should include all instances of the selection, retention or realisation of investments and of the exercise or non-exercise of rights (including voting rights) attaching to investments which

²³ by virtue of Regulation 11(A) of The Occupational Pension Schemes (Investment) Regulations 1996, SI no 3127, as amended by SI 1999 No 1849), the provisions now being now contained in regulation 6 of The Occupational Pension Schemes (Investment) Regulations 2005 .

²⁴ *ibid*

departed from the statement of principles. An explanation should also be provided for departures made in previous years if the investments involved continue to be held at the scheme's year-end and if the departure related to their selection or retention. Remedial action referred to in the statement should include any action relating to a rectification of the specific departure in question or to changes in general scheme governance procedures designed to prevent similar departures .”

(iv) **More fundamentally, however, requirements to state departures from the SIP will be of limited effect if the SIP itself is not sufficiently detailed in describing the scheme's RI policies, whether in relation to stock selection or engagement, so as to provide a yardstick against which to measure compliance.** Our RI Performance Review identified such lack of detail as a widespread problem. **Furthermore, reporting should not be limited to specific breaches of the SIP but should provide a comprehensive review of how the SIP has been implemented. Regulation should therefore be strengthened in both these respects.**

The first point, more detailed statements in the SIP, could probably be most easily covered by amendments to the provisions of 2005 investment regulations which already require SIPs to state their RI policies.²⁵ Such amendments might usefully adopt provisions from other jurisdictions that are now more advanced than the UK in these respects. For example, Australia requires schemes not only to disclose “the extent to which labour standards or environmental, social or ethical considerations are taken into account” in investment decisions but also specify **which** such standards or considerations they take into account and **how far**. As for engagement policies, the SIP could be required to state **precisely which ESG factors are covered**.

The second point, implementation of RI policies, could probably be best met by an expansion of sub-paragraph (c) of Paragraph 14 of Schedule 3 (quoted above) relating to the review of investment performance. The review could be required to disclose, for example:

- (a) the full SIP;**
- (b) the integration of the RI policy into fund manager selection;**
- (c) the integration of RI policy into Investment Management Agreements;**
- (d) details of measures taken to ensure monitoring and implementation of the RI policy;**
- (e) details of engagement activities by the scheme or its fund managers;**
- (f) the full voting record;**
- (g) the 100 largest equity holdings; and**
- (h) the RI policy in relation to non-equity asset classes.**

The need for specific requirements on such matters is evidenced by the findings of our RI Performance Review in relation to each of the above items: the Review revealed serious failings on the part of many of the schemes surveyed.

Consultation question 4

“Do you support the proposal for regulations to require relevant information to be provided “within a reasonable period” backed with a code of Practice, replacing the existing approach where timescales are specified in regulations?”

We do not support this proposal. As a general principle, we think that as the primary purpose of disclosure is the protection of members' rights and interests, the time limits for complying with

²⁵ See footnote 22.

members' requests should be **clear and simple**, which means that they should be **explicit**. It could be argued that a Code of Practice might sometimes put pressure on trustees to provide information sooner than is required under the present regulations. (Indeed, in our view, some of the current time limits are too lax: the two months allowed to supply a copy of the annual report or of the SIP, mentioned above, being cases in point.) We think, however, that the regulations should generally require disclosure “as soon as reasonably practicable and in any event within [specified period]”, which would meet this point. Amending the overarching principle so that it required the **timely** provision of information to members would also be helpful here. (See our reply to consultation question 1.)

Consultation question 5

As will be apparent from our answer to consultation question 4, we agree with the suggestion in paragraph 4 of Annex 3 that there should be a fixed period for the provision of basic scheme information when a new employee commences pensionable service. This, however, would be as part of an overall retention of fixed compliance periods, and not as an exception to a non-prescriptive regime.

Consultation question 6

“Do you have views on the proposal to allow greater use of electronic communications and on how schemes could make significant cost savings from this change? (See paragraph 35 above and paragraphs 39-40 of Annex).”

In general, we support the provision of information in electronic rather than written form, both because this will enable schemes to reduce costs and because it is more environmentally friendly. At the same time, we also agree that care needs to be taken to cater for those members and pensioners who do not have ready access to email or the internet; it is essential that they do not suffer any kind of exclusion as a result of this change.

In our view, however, **the most significant contribution that information technology can bring to disclosure is the expanded use of scheme websites.**

As we have already indicated in our answer to consultation question 3, we think that the disclosure regime should be **proactive** rather than **reactive**: information should be volunteered, not extracted. To some extent, this is already so, as with much of the information prescribed in Schedule 1 to the 1996 Regulations (basic information about the scheme) and in Schedule 2 (information to be made available to individuals). In the case of Schedule 3 (information to be included in annual report) and other documents such as the SIP, however, the onus is largely on the individual member to request information.²⁶ **This undermines the accountability and monitoring function of disclosure**: if members are not furnished with full information about, for example, the scheme's investment and engagement policies and their application, they will likely be unaware even of the existence of matters which might give rise to questions or concerns.

An informative scheme website should be a solution to this problem. We think, therefore, that the disclosure regulations should require schemes to maintain websites and should prescribe the minimum information to be posted. This information should include the annual reports (expanded as suggested in our reply to consultation question 3) and the trust deed and rules. One of the advantages of this approach is that as the documents in question would have to be prepared anyway, the additional cost involved in uploading them to the website would be modest.

The regulations might also require additional information. For example, there could be regular updates to the published details of investments held by the scheme. Any such extra requirements would have to take into account practical issues of cost and scheme resources and it might be appropriate for different provisions to be made for different sizes of scheme.

²⁶ Regulations 6 and 7 of the 1996 Regulations

With regard in particular to smaller schemes, we suggest that consideration be given to either the DWP or the Pensions Regulator providing a template of a scheme website that schemes with limited resources could make use of.

A further advantage of using scheme websites for disclosure is that they can (and should) be accessible to the trustees and members of other schemes and to the public. In view of the public interest dimension of RI, this is an important point. This general openness would encourage the dissemination of best practice,

It is now eight years since the original Myners Review suggested that a strengthened SIP, which stated what the trustees were doing to implement its principles, should be distributed to members annually²⁷ and that such annual reporting

“should develop into a forum for decision-makers to explain and justify their approach, and for stakeholders to exercise oversight of the decisions made on their behalf”²⁸

Likewise, it is now over four years since the Government's consultation document on the Myners principles proposed the following revised principle 10 (Regular reporting):

“Trustees should publish their Statement of Investment Principles and the results of their monitoring of their own performance, and that of advisers and managers. They should send key information from these annually to members of these funds, as well as posting this on a fund website, including an explanation of why the fund has chosen to depart from any of these principles. It is good practice for funds with more than 5,000 members to have a website dedicated to the fund.”²⁹

Most recently, Principle 6 (*Transparency and reporting*) of the new updated Myners principles published in October 2008, has provided that

“Trustees should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives”

but, in line with the non-prescriptive philosophy of the new principles, it goes on to say merely that

“Trustees should provide regular communication to members in the form they consider most appropriate”.

In the related “tools” section, there is a bare reference to “Websites/helplines (for larger schemes)” but no further guidance in this respect.³⁰

Our RI Performance Review provides evidence that these various guidelines have had little effect. The review revealed that 25 of the 30 schemes surveyed had some form of public website but that only a limited number of these provided relevant detailed information. For instance, 19 schemes made their annual report available publicly, but only 14 published either full or summary SIPs and only 12 made further detailed disclosure of their RI policies. Even more disappointingly, only 8 schemes publicly disclosed policy implementation and monitoring measures, while a mere 5 schemes published full voting records or details of engagement initiatives. Given the size of the schemes in the survey, it is reasonable to suppose that average disclosure standards among UK schemes generally is even lower.

²⁷ *Institutional Investment in the United Kingdom; a Review*, Paul Myners, March 2001, Chapter 11, Paragraph 11.5

²⁸ *ibid*, Paragraph 11.4

²⁹ *Myners principles for institutional investment decision-making: a review of progress* December 2004, page 37

³⁰ *Updating the Myners principles: a response to consultation*, October 2008, Page 22

http://www.hm-treasury.gov.uk/d/consult_myners_response-pu632.pdf

We see no reason to expect that the new *“high level”* Myners principles will bring about the far-reaching improvements in website disclosure that are needed, especially as the principles are now *“owned”* by an Investment Governance Group which is largely drawn from the pensions industry and which has no member representatives.

We therefore consider that regulation of the kind we have outlined above should be introduced as soon as possible and, in particular, should not be put on hold pending the review of progress under the new Myners principles that the Government is proposing to carry out in two years time. Conversely, we believe that it would be wrong for the Government to proceed with the more deregulated disclosure system envisaged in the Consultation Paper without even waiting to see whether the new Myners principles will indeed deliver an adequate level of disclosure in practice. In our view, this consideration applies not just to the question of scheme websites but to disclosure reform generally.