

21 April 2011

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Dear Darran Burton

UKSIF response to The Pensions Regulator Discussion Paper 'Enabling good member outcomes in work-based pension provision'

Thank you for the opportunity to comment on this discussion paper.

Summary

It is increasingly recognized that enabling good member outcomes in work-based pension provision requires responsible investment and ownership of assets.

In our judgement, this requires in turn:

1. A wider interpretation of “appropriate investment decisions” and “protection of assets” than is suggested by this discussion paper. Wider interpretation of “appropriate investment decisions” is also needed, we believe, to enable The Pensions Regulator to address its duty as a public body to promote equality.
2. A well-functioning investment chain within which market failures (including market failures related to member demand) have been addressed effectively. Governance and transparency improvements across the investment chain and greater civil society scrutiny are likely to be needed to achieve this.
3. A sufficient pool of appropriate investable assets as a result of effective public policy measures both within the UK and internationally. This includes measures to address issues such as the low carbon transition, resource depletion and corruption. We suggest that this is a seventh element necessary to achieve the good member outcome of an adequate income in retirement. While The Pensions Regulator may not be able to play a direct role in addressing this element, it can have impact through advocacy and influence.

The responsible investment approach announced last month by the National Employment Savings Trust (NEST) offers a valuable benchmark for work-based pension provision on the first of these issues.

Question 1: Do you agree with the regulator’s 6 elements of good DC provision? What additional elements, in any, are important?

We agree that all six elements are necessary, ie. appropriate contribution decisions, appropriate investment decisions, efficient and effective administration, protection of assets, value for money and appropriate decumulation decisions.

Of these elements, there is a risk that two in particular are interpreted too narrowly:

- **Appropriate investment decisions** should include appropriate decisions within the investment chain as well as by the member and employer. This requires a well-functioning investment chain

in which market failures have been addressed effectively, including market failures related to member demand. This requires improvements to governance, transparency and scrutiny.

This element should also include those investment decisions that enable members to support their overall well-being at the same time as achieving narrower financial outcomes, including their ability to reflect their values and social priorities in investment decisions. This is important to support equality and diversity as well as general member well-being. “Appropriate investment decisions” needs to include those which religious members and others with protected characteristics may wish to make. We believe that consideration of this particular aspect is essential to enable The Pensions Regulator to address its duty as a public body to promote equality.

- **Protection of assets** should include responsible asset ownership and the effective integration of material environmental, social and governance risks into investment decision making. In contrast, the discussion paper appears to interpret this element as limited to the holding of contributions securely. Effective protection of asset value during investment decision making requires a well-functioning investment chain, including measures to address market failures in member demand. This requires improvements to governance, transparency and scrutiny.

In addition, a sufficient pool of appropriate investable assets is required that enables the investment and management of pension assets over the long-term. We suggest that this is a seventh element necessary to achieve the good member outcome of an adequate income in retirement. It requires a range of public policy measures, including measures to address major threats to wealth creation/protection and economic success such as climate change, resource depletion and corruption. For example, the successful and rapid transition to a low carbon economy worldwide may have a greater impact on good member outcomes than some of the pension-specific elements identified in this discussion paper. While The Pensions Regulator may not be able to play a direct role in enabling such an asset pool, it can have significant influence as an advocate for the importance of this wider public policy framework for good member outcomes.

Question 7: What are the most important product characteristics of DC pensions which determine good member outcomes?

Key product characteristics include:

- Appropriate management of long-term responsible investment aspects, including responsible asset ownership (eg. using the UK Stewardship Code), to protect and grow asset value
- Appropriate member choice to enable members (including diverse members) to integrate their values and social priorities into their investment decisions if they wish to do so.

Question 8: How can the regulator, or others, best encourage suppliers to ensure the presence of these characteristics in their products?

We believe that The Pensions Regulator should require information to be disclosed to members and the general public about the investment principles and beliefs followed within pension products in relation to environmental, social and governance issues together with how these principles and beliefs are implemented in practice. While some parts of this are currently required by legislation for some types of pensions, this is not required today in total or for all.

We note that the European Commission has consulted recently on Packaged Retail Investment Products (PRIps). This consultation included questions about improved transparency about the social and environmental impacts of investments and also about risk rating (where there is an increasing recognition of the importance of environment and social risks to resilient investments). For example, the consultation asked “Q30: What detailed steps might be taken to improve the transparency of the social and environmental impacts of investments in the KIID for PRIps?”¹ We believe that any measures implemented for PRIps should apply also for work-based pension provision.

Please see also our response to Question 11.

¹ http://ec.europa.eu/internal_market/consultations/docs/2010/priips/consultation_paper_en.pdf

Question 10: Is there sufficient understanding of, and attention to, the protection of assets, particularly amongst trustees?

UKSIF welcomes the increased trustee demand in recent years for long-term responsible investment, including responsible asset ownership (eg. using the UK Stewardship Code), to protect asset value. However, UKSIF members report that significant improvement in trustee demand is still needed to support the effective protection of assets. In particular, trustees should include responsible ownership and investment requirements more explicitly within investment mandates or product selection decisions and measure manager performance on these issues using appropriate metrics.

Question 11: To what extent, and how, can less engaged or knowledgeable employers be helped in choosing a pension scheme which will deliver the good member outcomes identified in this document?

NEST offers a benchmark for responsible investment and ownership, including member choice, which could be used to assist less engaged or knowledgeable employers. In particular, NEST's investment approach, announced last month, includes

1. The second of NEST's seven published investment beliefs is "as long-term investors, incorporating environmental, social and governance (ESG) factors within the investment process is in the best interests of our members."
2. NEST will seek to apply responsible investment principles across all the assets in which it invests.
3. NEST will become a signatory to the UN-backed Principles for Responsible Investment (PRI) and the UK Stewardship Code. [Note: Employers could require this of their pension providers even if, for example, smaller occupational schemes chose not to join PRI directly themselves.]
4. The range of five fund choices initially available (in addition to the default fund) will include the NEST Ethical Fund and the NEST Sharia Fund.

Pension providers might be required or encouraged to provide information for such employers which benchmarked their offerings against this NEST approach.

UKSIF – the Sustainable Investment and Finance Association

UKSIF, the sustainable investment and finance association, promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. We aim to support the UK finance sector to lead the world in advancing sustainable development through financial services.

UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 250+ members and affiliates include pension funds, institutional and retail fund managers, banks, financial advisers, research providers, consultants and non-governmental organisations. For more information about UKSIF, please visit www.uksif.org.

With best wishes



Penny Shepherd MBE

Chief Executive

UKSIF – the sustainable investment and finance association