



Personal accounts: a new way to save

PIRC's Response to the DWP White Paper

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1. Introduction

We welcome the opportunity to respond to the consultation on Personal Accounts. Pensions & Investment Research Consultants Ltd (PIRC) has been an independent adviser to pension funds and other institutional investors for over 20 years. PIRC's clients have combined assets in excess of £750 billion and include some of the largest pension funds, investment management companies and insurance companies in the UK and overseas. Together, they comprise a diverse group of institutional investors with long-term liabilities and broad fiduciary duties.

PIRC undertakes company research on corporate governance and corporate social responsibility issues at public companies, and provides advice to clients on proxy voting strategies and other active shareholder initiatives. Our comments are based on two decades of practical experience, which inform our views on the strengths and weaknesses of disclosures, governance structures, and the interaction of statute, regulation and codes of practice.

We have only commented on those areas of the White Paper where we have particular views and expertise.

2. General comments

PIRC is supportive of the Government's broad agenda for reform of the funded pensions system. We believe that a compulsory pension system, such as that introduced in Australia, would significantly increase coverage across the workforce as a whole, and proportionately even more amongst female employees, who have not traditionally been well served by the pension industry. However we recognise that the auto-enrolment approach advocated by the Government should achieve greatly increased levels of coverage whilst also providing individual savers with a degree of flexibility.

We strongly endorse the Government's decision to require a contribution from employers to Personal Accounts. This will both ensure that there is a real benefit to employees in joining the scheme, and create a level playing field for employers. Without this requirement it is possible for some businesses which do not currently contribute to employees' pensions to use this as a competitive advantage. We note that this point has been made forcefully by employers in the small and medium-sized business sector by the Engineering Employers Federation.

In the longer term we believe it will be necessary to review whether a combined contribution of 8% of salary is sufficient to provide a decent funded retirement income on top of state benefits. PIRC would argue therefore that the Personal Accounts Board should be given the responsibility to regularly review contribution rates to ensure that they are set at appropriate levels, and advise the Government accordingly. We do not believe therefore that it would be prudent to write the employer contribution rate into primary legislation. We accept that it would provide clarity and certainty to employers, but the primary objective should surely be the

creation of decent retirement incomes for scheme members.

In any case we do not believe that alterations in the contribution rate would necessarily be significant, nor do they need to be introduced in one stage. We note that the Australian superannuation system phased increases in employer contribution rates over a number of years. An alternative provision could be made in legislation that the contribution should not be increased by more than a given amount over a given period (ie 1% each year).

In addition we support the Government's decision to develop Personal Accounts as an occupational pension scheme, in line with the Pensions Commission's original proposal for a National Pension Saving Scheme. We believe that a single fund will be able to deliver a cost-effective retirement saving scheme. We saw nothing in the alternative proposals (such as a variety of branded providers) that would have offered a better deal for those who will join the scheme.

3. The need for proper member representation

PIRC believes that it is essential that there is proper member representation on the Personal Accounts Board for a number of reasons.

First, the Personal Accounts scheme is specifically referred to as an occupational pension scheme. The Government has already stated its aspiration that by 2009 all occupational schemes should equal employee and employer representation on their trustee boards. It would not be acceptable for the PAB to fall below the best practice that the Government has set out for other occupational schemes.

Secondly, equal member representation is already a well-established governance arrangement in many large occupational schemes. For example one survey found that more than half the occupational schemes surveyed had at least half of the trustees on their boards drawn from the scheme membership¹. In addition, given the size that the Personal Accounts scheme will potentially grow to, there will no problem in recruiting potential member 'trustees' – an argument sometimes used against extending member representation in other occupational schemes.

Going further, given that the Personal Accounts scheme is to be established on a defined contribution basis members will be subject to significantly more financial risk than employers. This risk is not solely related to investment performance, but also fund choice, annuity choice and so on. Therefore PIRC believes that there is a strong case for greater representation for member and consumer interests than employers in the governance of the Personal Accounts scheme.

One option would be to include consumer/public interest representation in the governance of the scheme. Representation on the PAB could be split between one third employees, a third employers and a third consumer/public interest.

¹ <http://www.tuc.org.uk/pensions/tuc-10882-f0.cfm>
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The selection of representatives on occupational schemes is typically achieved through an election. Whilst this would be possible in the Personal Accounts scheme, an alternative might be for relevant organisations (ie CBI, TUC, Which?) to nominate representatives.

4. Provision of SRI fund options

PIRC welcomes the positive commentary included in the White Paper about the inclusion of fund options that consider social, environmental and ethical issues. As the NAPF has pointed out, almost 40% of occupational DC schemes now include at least one socially responsible investment (SRI) fund option. This is particularly common amongst larger schemes.

We therefore believe it would simply be best practice for the Personal Accounts scheme to include such an option. As such we believe that the PAB should add SRI options to the range of funds available and resist any lobbying against their inclusion on partisan political or ideological grounds. Members' freedom to choose an SRI option should not be hampered by political interference.

It is also important to stress that SRI fund options need not be 'screened'. An increasing number of pension funds and other institutional investors that introduce and SRI policy use the alternative strategy of 'engagement' where the investors use their share-ownership as a way to encourage higher standards of corporate governance or corporate social responsibility. This is an important distinction because it means that an SRI strategy can be adopted that does not restrict asset allocation and/or stock selection. In addition funds can use alternative strategies, such as the targeted use of shareholder voting rights, to promote good governance and CSR practices.

More importantly this means that an engagement strategy could overlay the scheme's entire assets rather than being applied to a single niche fund. This question is explored in more detail below.

5. The ownership stance of the default and other funds

PIRC believes it is important that the 'ownership' implications of the Personal Accounts scheme are properly considered. It seems likely that the large majority of members of the Personal Accounts scheme will remain in the default fund. As such this fund will become a significant investor in its own right. Therefore what sort of 'ownership' stance should it adopt, for example in relation to the exercise of voting rights? There are good reasons for the Government to think carefully about this.

Amongst existing occupational pension schemes there are different approaches. Most schemes delegate authority for shareholder voting and engagement to their appointed fund managers. However an increasing number decide their own policy centrally (ie within the trustee board) and instruct the fund managers to apply it. The PAB will effectively face the same choice.

Simply delegating the voting and engagement policy of the Personal Accounts scheme to the appointed fund manager(s) runs a number of risks. First, the manager chosen may not have a strong commitment to governance. As the limited voting data that is publicly available in the UK demonstrates, there are significant differences between managers. It may simply not be possible to appoint a manager with both good performance and an active approach to share-ownership.

Secondly, what happens when, inevitably, the fund manager is changed because of poor performance? If the policy is delegated to the manager then the ownership stance taken by the fund will change when the assets are transitioned. That might not matter in a DC scheme run by a small business, but in a multi-billion pound national scheme it could have a major impact. A previously robust stance on corporate governance taken by a major market participant may overnight be weakened.

Finally, there is the risk of votes being cast in different ways. There will inevitably be instances where the default fund and other funds offered to members of the Personal Accounts scheme hold shares in the same company. If voting and engagement policy is delegated to the fund managers this will surely at some point result in the scheme voting for and against the same proposal.

A central policy

As such it would be sensible for the Personal Accounts Board (PAB) to adopt a central ownership policy that is applied across all of its assets. It is worth recapping where the market stands at present. If research by the NAPF² and the Investment Management Association³ is accurate, then an increasingly number of both pension funds and fund managers are taking voting and engagement seriously. Therefore it would be difficult for the PAB to adopt a position that lags behind industry best practice. In addition it is worth noting that the Pension Protection Fund has a Statement of Investment Principles (SIP)⁴ that is considerably more positive about corporate governance and social responsibility than many of the boilerplate disclosures in private sector scheme SIPs, so there is a precedent.

Introducing a centrally-decided voting and engagement policy should therefore not be seen as a radical proposal. Rather it would be a logical way for the Personal Accounts scheme to achieve the best practice that the Government expects of any other occupational pension fund. The Personal Accounts schemes' policy would be disclosed in its own SIP.

6. Enfranchising individual investors

The question of voting rights should not only be considered in relation to the scheme as a whole. We would also urge the Government to explore the possibility to allow

² <http://www.napf.co.uk/engagement%20survey%20final.pdf>

³ <http://www.investmentuk.org/press/2006/20060621-01.pdf>

⁴ <http://www.pensionprotectionfund.org.uk/sip2006.pdf>

individual members of the Personal Accounts scheme to exercise shareholder voting rights themselves. PIRC was supportive of the Government's moves to enfranchise individual investors in the Companies Act. We believe it is logical for this approach to be carried through to the implementation of the Personal Accounts system.

It might not be practical to seek to allow scheme members to exercise voting rights in respect of each individual company that they are exposed to, although the possibility should be explored. However at the very least it should be possible for an individual to create, or select, a voting template that would give fund managers a clear indication of how they would want their voting rights to be exercised.

Such a template might be based on existing corporate governance best practice as outline in the Combined Code. In addition, as outlined earlier, it is possible for voting rights to be used strategically in relation to companies' records in relation to corporate social responsibility issues. Therefore individuals may wish to develop, or select, a voting template based on social or environmental issues.

We do not believe that the recommendations for setting a central 'ownership' policy for the Personal Accounts scheme, and allowing individuals to have some control over voting rights, represents an either/or choice. Rather PIRC believes that both are necessary. In the first instance the PAB would be acknowledging that it will be a significant institutional investor that has ownership responsibilities, as detailed in previous Government initiatives such as the Myners Review. In the second the PAB would merely be extending the Government's existing policy to enfranchise indirect investors already in place in the Companies Act.

PIRC would be happy to discuss the points we have made in our submission in more detail. Please contact:

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