Our Money, Our Business

Building a more accountable investment system

ShareAction
the movement for Responsible Investment

About ShareAction

ShareAction (formerly FairPensions) is a UK registered charity that exists to promote an investment system which serves savers, society and the environment. In particular, we work to encourage pension funds and other institutional investors to be active owners of listed companies, and to integrate long-term environmental, social and governance (ESG) risks into investment analysis and shareholder engagement. We also work to improve transparency and accountability to the savers whose money is invested in the capital markets.

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Contents

Executive Summary 2

Introduction 7

Chapter 1: The case for a more accountable investment system 10

Chapter 2: Enhancing transparency 21

Chapter 3: Empowering and involving savers 31

Chapter 4: Harnessing new technology 39

Conclusion and Recommendations 47

Appendix: List of roundtable participants 49

References 50

Executive Summary

> The actual owners of the world's corporations are no longer a few wealthy families. They are the huge majority of working people who rely on today's largest companies to safeguard their pensions and life savings.
>
> ***Davis, Lukomnik & Pitt-Watson***
> ***'The New Capitalists: How citizen investors are reshaping the corporate agenda'***

Capitalism is suffering a crisis of confidence. From LIBOR-rigging to tax avoidance to excessive executive pay, in recent years public anger over the behaviour of the banks has spilled over into a more general loss of trust in corporations. Policymakers have turned to shareholders to rein in corporate excesses - but the investment industry itself has not been immune from the decline of trust.

Public opinion tends to position the average citizen as a helpless bystander in this drama, when in fact it is their money which underpins the entire system: anyone with a pension is, indirectly, an owner of Britain's biggest companies. This report envisions a world in which people feel that their savings give them a positive stake in the economy and a voice in how businesses are run.

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The rise of private pension savings has led to a 'democratisation' of company ownership. But when it comes to control over ownership rights, the reverse is true: power has become increasingly concentrated in the hands of a relatively small number of opaque and unaccountable financial institutions. And, as the Kay Report showed, these institutions often face systematic pressures to act in ways which may not serve savers' interests. Direct accountability to savers is therefore a vital component of a healthy economic and financial system. As millions more savers are about to enter the capital markets through pensions auto-enrolment, now is the right time to build a more accountable system.

The case for a more accountable system

Better companies and better capitalism

In recent decades, efforts to improve the way companies are run have focused heavily on making directors more accountable to their shareholders – for example, the recent introduction of a binding 'say on pay'. But this is a job only half done: ownership rights are exercised largely by institutions who are themselves intermediaries, and accountability to the underlying savers who provide the capital remains weak. The logical next step must be for institutional investors to extend the same accountability which they expect from companies to the savers they represent.

Indeed, such accountability is essential to the success of recent measures to encourage more engaged and responsible share-owners. The UK Stewardship Code was introduced in the aftermath of the financial crisis to address concerns that shareholders were behaving as 'absentee landlords'. Rather than being enforced by regulators, it is a voluntary code which relies on scrutiny from below to promote compliance – mirroring the Corporate Governance Code for companies. Yet, while shareholders are given extensive rights to hold companies to account for their governance practices, savers are not equipped to play the same role in relation to institutional investors.

Indeed, while the stewardship agenda has emphasised the exercise of shareholder 'voice' to influence companies, savers themselves continue to have little or no voice in the management of their investments.

> *While the stewardship agenda has emphasised the need for investors to use 'voice' rather than 'exit' as a means for influencing companies, savers continue to have little or no voice in the management of their investments*

Putting savers back at the heart of the investment system would also help to 'rehumanise' company ownership. Instead of an abstract 'duty to shareholders', which can all too easily become a duty to the share price, company directors might begin to think in terms of their duty to the millions of real people who depend on their stock. Likewise, institutional investors themselves might cease to think in terms of a crude 'duty to maximise returns', as if their portfolios existed in a vacuum, and concern themselves more with the real-world interests of the people they serve: for example, their interest in a stable financial system, or in avoiding the economic risks posed by climate change.

As well as better protecting savers' long-term financial interests, this would be good news for those who believe that capitalism has lost its moral compass. If policymakers want capitalism to have a conscience, then capitalist institutions must be accountable to real human beings, and not only to an abstract ideal of profit maximisation. In addition, savers who feel connected to their money are more likely to see it as an arena for the expression of their values.

Efficient and effective markets

Transparency and accountability should also matter to those whose only concern is making markets work more efficiently. Efficient market theories presume that consumers act in their own self-interest. But in the capital markets, decisions are not being made by consumers but by intermediaries acting on their behalf. Moreover, consumers themselves are deeply disconnected from their money: the 'opt-out' mechanism of pensions auto-enrolment is predicated on this fact. This means that intermediaries themselves are subject to limited market discipline.

The pensions market may never be dominated by active and engaged consumers – but the more consumers are active and engaged, the better the market will work. In addition, accountability should build trust in the system even among those who do not choose to engage – thus encouraging people to keep saving. This is an important consideration in a market where just 7% of retail investors trust investment firms to "do the right thing", and consumers cite lack of trust as the number one reason for opting out of private pension saving.

> *Practical objections on the grounds that savers are not interested or not capable of engaging with their money simply perpetuate a vicious circle of disengagement.*

Addressing objections to accountability

Legal objections to the idea of empowering savers are generally based on outdated conceptions of trust law which have little place in the world of modern investment. Paternalistic ideas about passive beneficiaries, developed in the context of private family trusts, are inappropriate in the context of pension schemes, where savers have effectively paid for their benefits. Moreover, greater involvement from savers is not incompatible with trustees' fiduciary duties, as is sometimes argued: we are not suggesting that savers should usurp trustees' discretion to make decisions, merely that they should have the right to have their views taken into account when those decisions are made.

Practical objections on the grounds that savers are not interested or not capable of engaging with their money simply perpetuate a vicious circle of disengagement. Savers may be put off by the language of investment, but that does not mean they are not interested in where their money goes. The onus must be on the investment industry to communicate with savers in a way they find meaningful. Likewise, savers may lack understanding of the technicalities of investment, but there are many matters on which they are qualified to comment, including the way their scheme behaves as an owner of major companies, or its policy on ethical issues. Indeed, emphasising the positive contribution schemes are making to a better economy through their exercise of ownership rights could be a 'way in' to engaging people with saving more widely.

> *“Pension savers have no right to know where their money is being invested”*

Enhancing transparency

Pension savers' rights to information about their money are currently extremely limited. In a world where savers' wellbeing in retirement depends on investment decisions made by people they did not choose, this is likely to become increasingly unacceptable.

For example, pension savers have no right to know where their money is being invested: schemes are not obliged either to publish a general overview of the companies they hold, or to respond to specific requests for information. It is sometimes argued that responding to such requests is impossible, since pension funds do not hold company shares directly but through externally managed funds. Yet, as recent scandals in the food industry have highlighted, the existence of lengthy supply chains makes the ability to trace what lies behind a packaged product all the more important. Put another way, consumers have the right to know whether there is 'financial horsemeat' in their pension funds.

> *“Savers also have very limited rights to regular reporting about how investment strategy is being implemented”*

Savers also have very limited rights to regular reporting about how investment strategy is being implemented. Although some pension schemes are obliged to publish annual investment reports, these do not have to explain how they have implemented their investment policy, how they have exercised ownership rights attaching to investments, what their investment strategy is going forward, or how they are managing long-term risks to savers' money. This contrasts with companies' narrative reports, which must include a forward-looking explanation of the company's strategy and risks. This is an anachronism which is no longer appropriate in the world of auto-enrolment.

Common objections to greater transparency include the claim that savers will not use the information; that reams of disclosure will create information overload; and that the costs of disclosure will far outweigh the benefits. In our view, none of these objections are convincing. We are not arguing for a world where savers are bombarded with huge amounts of meaningless data. Rather, we think savers should be given clear, concise and meaningful information about what is being done with their money, and should have the right to receive more detailed information on request.

Moreover, the case for public disclosure of certain information rests not only on how many individual savers will directly access it, but on the use that can be made of it by consumer groups, academics and civil society organisations – both to provide consumers with accessible comparisons, and to analyse how the system as a whole is working. The experience of mandatory voting disclosure for US mutual funds shows how this can work in practice – and suggests that complaints about costs are overstated.

Engaging and involving savers

Transparency is necessary but not sufficient for a more accountable investment system: savers must also have the right to engage directly with decisions about their money, in the same way that shareholders engage with companies. Of course, we are not suggesting all savers should be consulted on every decision. In our view, engagement with savers has three key elements:

- *Proactive participation.* Savers should have the right to be consulted about investment policies, particularly those which should be firmly grounded in the views of savers, such as ethical investment policies. It is sometimes argued that, since savers will inevitably disagree, acting on their views is either practically impossible or (in the case of trust-based schemes) potentially unlawful. The former objection can be refuted by example: schemes like PKA in Denmark and NEST in the UK demonstrate the possibilities for using face-to-face engagement with savers to inform the development of policy. The latter objection rests, in our view, on a misunderstanding of fiduciary investors' duty of impartiality.

> *While companies are obliged to hold annual meetings at which the board accounts to their shareholders, no such requirement extends to pension schemes. Yet few investors have their entire life savings in a single company, but many pension savers are reliant on a single fund*

- *Retrospective accountability*. Savers should also be able to subject decisions made on their behalf to healthy scrutiny and challenge. In our experience, savers who write to their funds asking for an account of specific decisions often receive disappointing responses. Many savers appear to find their schemes so inaccessible that it is difficult even to ask a question at all. And, while companies are obliged to hold annual meetings at which the board accounts to their shareholders, no such requirement extends to pension schemes. Yet the case for such an accountability mechanism is if anything stronger: few investors have their entire life savings in a single company, but many pension savers are reliant on a single fund.

- *Direct representation.* Although not a substitute for engagement with savers at large, direct representation on decision-making boards is important. Currently, such representation is available to only a dwindling minority of pension savers (those whose schemes are obliged to appoint member-nominated trustees). Any new governing bodies for contract-based pension schemes should include some form of representation for savers.

Harnessing new technology

The internet has the potential to bring savers closer to the businesses in which their money is invested, and to spread influence over the exercise of shareholder rights more widely among those whose capital is invested. But this potential has so far gone largely unrealised. Evidence suggests that this is not because of any insurmountable technological or legal barriers (although it is true that the legal structures through which shares are commonly held act to distance savers from companies). For example, it would be perfectly possible for pension schemes and managers of collective investment funds to use the internet to poll savers on particular issues or controversial votes, using this to inform their own voting decisions. The key problem is a lack of commercial incentives for providers to innovate: low consumer awareness creates a 'chicken and egg' situation.

The emergence of radically new and more direct models of investing, building on the recent growth of crowd-funding and peer-to-peer lending, could conceivably strengthen these weak incentives for innovation. Although models where individuals directly choose to invest in particular projects or companies are likely to remain a relatively small part of the market, it is possible to envisage mainstream pension schemes 'bolting on' fund options which give savers more autonomy over at least a small portion of their savings. Short of this, mainstream investors can still learn from the appeal of these models: namely, the sense of connection they provide to tangible, positive activities in the real economy. Institutional investors could apply these lessons by simply changing the way they communicate with savers – for example, by demonstrating that their savings give them a stake in major companies and a chance to influence what they do.

Conclusion

Making capital markets more answerable to the individuals whose money they invest offers a potentially powerful lever both for rebuilding trust in the City and for promoting more responsible and long-termist corporate behaviour. Such accountability must be nurtured over time, by institutional investors, savers and civil society. However, policymakers have a vital role to play in setting a 'floor' by updating the legal regime to guarantee savers certain basic rights to information and participation. Below we summarise the rights we think savers should have; we hope this will act as a catalyst for further debate.

RECOMMENDATIONS:
RIGHTS TO KNOW AND TO PARTICIPATE

Savers should have the right to know:

- where their money is being invested
- how ownership rights are being exercised on their behalf
- their scheme's investment policy, including any policies on responsible ownership or ethical investment
- how the policy is being implemented
- how the scheme is managing future long-term risks to their money.

Savers should have the right to participate by:

- being consulted on investment and voting policies
- attending annual meetings where they can question their pension scheme's board
- receiving a substantive response to queries about specific decisions
- acting as a member representative on their pension scheme's board.

Government can lay the foundations for this by:

- clarifying the law to override outdated ideas about savers' rights to participate
- guaranteeing basic rights to information and participation
- actively seeking to educate current and future savers about what investment means.

Introduction

> It's finance that becomes disconnected from the economy, from society, finance that only talks to itself and deals with each other, that becomes socially useless.
>
> ***Mark Carney, Governor of the Bank of England, August 2013***[1]

Capitalism is suffering a crisis of confidence. From LIBOR-rigging to tax avoidance to excessive executive pay, in recent years public anger over the behaviour of the banks has spilled over into a more general loss of trust in corporations. Policymakers have turned to shareholders to rein in corporate excesses - but the investment industry itself has not been immune from the decline of trust. A recent survey by the CFA Institute found that only a third of UK retail investors trusted the financial services industry, and just 7% believed that investment firms "do the right thing".[2] The Parliamentary Commission on Banking Standards concluded that empowering shareholders was more likely to encourage banks to take excessive risks than to restrain them.[3] There is a widespread belief that the City has become self-serving, disconnected from its customers and from the real economy.

Public debate tends to position the average citizen as a helpless bystander in this drama, when in fact it is their money which underpins the entire system. 'Shareholders' are often spoken about as an abstract force, and yet almost anyone with a pension is, indirectly, an owner of Britain's biggest companies. What if savers came to see themselves not as passive victims in debates about corporate responsibility, but as owners with a stake in the system? What if 'investment' ceased being at best a dry and abstract term and at worst an object of fear and suspicion, and instead became a by-word for putting your money to work in the real economy? And what if companies seeking to serve their shareholders thought not of 'the market' and its obsession with today's share price, but of the millions of savers whose pension schemes hold their stock over decades?

As millions more savers are about to enter the capital markets via pensions auto-enrolment, now is a timely moment to ask these questions. The mass expansion of pension savings in a climate of mistrust clearly presents risks, but it also represents an enormous opportunity - both to restore trust in markets and to promote more responsible corporations. This idea is not entirely new: the rise of pension funds in recent decades generated a wave of optimistic predictions about a new era of capitalism, where financial markets would increasingly serve the public interest. After all, these major players had a natural mandate to answer to the real 'capitalists' - the millions of people, many on modest incomes, who relied on them for security in old age.[4]

> ***What if savers came to see themselves not as passive victims in debates about corporate responsibility, but as owners with a stake in the system?***

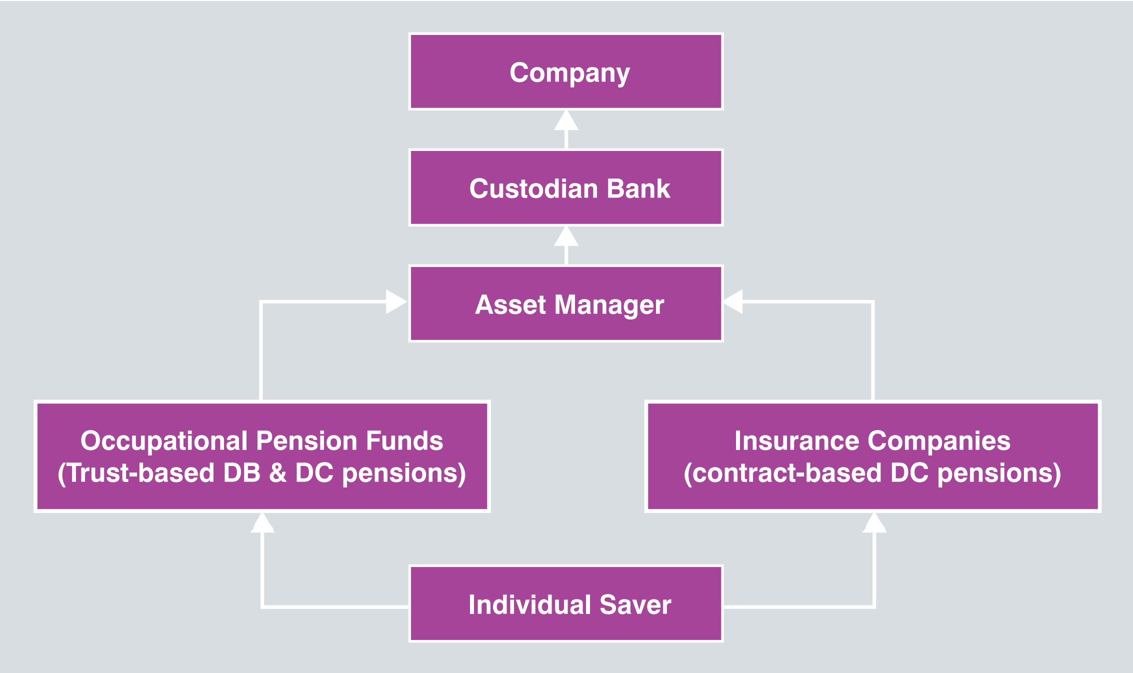
These predictions have so far failed to materialise. Instead, as the Kay Review noted, we have witnessed the rise of the intermediary. Individuals are separated from their investments by a lengthy chain of agents (see box overleaf). Rather than being dispersed into the hands of millions of savers, power has become increasingly concentrated in the hands of a relatively small number of financial institutions. And, despite growing acceptance of the principle that investors should consider environmental, social and governance (ESG) issues to the extent that they may affect financial return, there has not been the sea change towards long-term, responsible investor and company behaviour that many hoped for.

From the Cadbury Report of 1992[5] to the introduction of a binding shareholder 'say on pay' in 2012, UK corporate governance policy has been resolutely focussed on making company boards more accountable to their shareholders. But this is a job only half done. As the Kay Review forcibly reminded us, the shareholders charged with overseeing companies are themselves intermediaries. Efforts to improve accountability have not yet reached as far as the individual citizens whose capital is at stake. This matters because, as Kay points out, institutional investors are subject to systematic pressures which may prevent them from acting in the long-term interests of the people they exist to serve. As ShareAction argued in our 2012 analysis of the 'Shareholder Spring',[6] reasserting the interests of the underlying saver is the missing link in the debate about responsible capitalism.

Of course, legal frameworks and incentive structures have important roles to play in ensuring that City intermediaries serve the people whose money they manage (as argued in our previous publications on fiduciary duty).[7] But this report is focussed on a different question: should we expect institutional investors to exhibit the same accountability to savers that they demand from companies?

Chapter 1 considers this question in general terms. Chapter 2 focuses on transparency (savers' rights to know what happens to their money), Chapter 3 considers the potential for direct engagement (savers' rights to express their views about their money and to scrutinise decisions made on their behalf), and Chapter 4 explores the possibilities opened up by new technology for fostering a more direct connection between savers and the companies

The investment chain: a simplified model



in which their money is invested. We conclude with some policy recommendations.

However, policymakers can only create the space for a more accountable investment system: it cannot be built from the top down. The report is therefore accompanied by a best practice guide for institutional investors which has been developed with input from an expert working group. The two documents should be read in conjunction. Throughout, our primary focus is on pension schemes (both defined benefit and defined contribution, both trust- and contract-based), but many of the issues we raise apply to other types of investment.

This report is based both on ShareAction's own research and on an expert roundtable held in May 2013. It has also benefitted from the insights of various industry experts who gave generously of their time to discuss the issues with us. Finally, it draws on research for a paper by Christine Berry and Charles Scanlan, written for the forthcoming Cambridge University Press Handbook on Institutional Investment and Fiduciary Duty. However, the views expressed in this report are those of ShareAction.

Note on terminology

The chain separating companies from the individual savers who provide the capital is increasingly long and complex. Opposite we presented a simplified model showing the main parties discussed in this report. This refers primarily to pension savings, which are the focus of this report: for other types of saving, the investment chain will look slightly different.

In this report, we use the following terms:

- "**asset owner**" to refer to pension funds and insurance companies,
- "**asset manager**" to refer to the fund managers who look after investments on their behalf,
- "**institutional investor**" to refer to both asset owners and asset managers, and
- "**saver**" or "**beneficiary**" to refer to the underlying individuals saving in these institutions.

We also use the term "**shareholder**" to refer to those who control and exercise shareholder rights in relation to companies (in practice, usually asset managers).

Chapter 1: The case for a more accountable investment system

> Nothing could do more for the sadly diminished popularity of business and businessmen than a growing sense of democratisation in their affairs.
>
> ***Ferdinand Mount, 'The New Few'***

In making the case for a more accountable investment system, it is important to be clear from the outset what we do and do not mean by 'accountability'. Firstly, we are not suggesting that individual savers should have the right to 'instruct' institutional investors to make particular decisions: however, they should have the right to be consulted and have their views taken into account as part of the decision-making process. Secondly, we are not suggesting that this consultation would relate to the day-to-day minutiae of investment decision-making, but rather to the setting of general policy. In relation to individual decisions, we see a role for retrospective transparency and accountability about the decision taken and the reasons for it. Of course, this should not prevent savers from making their views known in advance where they feel particularly strongly about a certain issue. In political terms, the analogy is to representative democracy rather than direct democracy.

It is also important to answer the question 'accountability for what?' As participants at our roundtable pointed out, transparency and engagement are not virtues in and of themselves. For instance, transparency about short-term fluctuations in performance can lead to an excessive fixation on those fluctuations - hence the Kay Review's recommendation that quarterly reporting by companies should be abolished. Our primary focus, here and throughout this report, is on the ownership of listed companies. We are concerned with reasserting savers' role as

A VISION OF A MORE ACCOUNTABLE INVESTMENT SYSTEM

Our vision is of a world in which institutional investors are expected to account to the people whose money they manage, in the same way that companies are currently expected to account to their shareholders. This means both transparent reporting about what institutions are doing with the money entrusted to them and how this relates to their long-term strategy, and also face-to-face interaction whereby the decisions of the board can be scrutinised. The rights of savers to have a voice in relation to their investments would be generally accepted.

How would this work in practice? In our view there are two key elements:

Transparency. We would expect a more transparent system to work in a way analogous to other consumer goods markets at present. Manufacturers of products from food to electronics are obliged to disclose certain information because it is broadly accepted that this serves consumer interests. Usually, only the general, high-level information is used directly by consumers themselves. But there is a healthy 'ecosystem' of consumer groups, academics and civil society organisations who use the more detailed data to study the market, identify problems, and provide consumers with ratings, comparisons and useful analyses.

Likewise, we are not suggesting that transparency of investment should equate to the disclosure of reams of detailed information to consumers, or that there will ever be mass consumption of detailed information. However, we do believe that much greater public transparency is needed about institutional investors' activities in order to build the kind of ecosystem which can both digest information for savers and use it to advocate directly for their interests. At present, its development is stunted precisely by the system's lack of transparency. For example, one pair of academic authors attempting to study the impact of new regulations recently spent two years seeking data under the Freedom of Information Act from pension funds who happened to be public bodies, because this was the only way to obtain a snapshot of what was happening in the broader market.[8]

Engagement. Transparency is necessary but not sufficient for a more accountable investment system. It is important to remember that pension savers in particular often have limited choice about where they put their money - so the informed consumer cannot be our only frame of reference. It is also appropriate to make an analogy with the political system, and in particular with the principle that people should be able to scrutinise and question decisions which affect their interests. In a more accountable system, institutional investors would engage in dialogue with savers through meetings, roadshows, surveys and consultations.

If this sounds impractical, it is worth noting that such dialogue appears to be the norm in many Danish schemes (see case study on p32). As with democratic dialogue, it is not necessary or likely that everybody would participate, but even a minority of savers could help to inform decision-making and subject powerful decision-makers to healthy scrutiny. It is to be hoped that, as this system created its own culture, participation rates would increase - while awareness of the right to participate would build trust in the system even among those who chose not to.

the ultimate owners of capital, and hence with their right to know where their money is going and how ownership rights are being exercised on their behalf - and to express their views about this.

In the box opposite, we summarise our vision for a more accountable investment system and the positive impacts we believe this would have. In the remainder of this chapter we set out in more detail the case for greater transparency and engagement, and address some common misconceptions and objections, both legal and practical.

Why accountability matters

ShareAction's primary concern is to promote a more responsible investment system, where institutional investors focus on generating long-term sustainable wealth for savers, having regard to their impacts on society and the environment, rather than simply seeking to profit from short-term fluctuations in asset prices. In our view, direct accountability to savers could help to build such a system. However, even those who believe that the notion of 'responsibility' has no place in debates about how markets should work have good reason to value accountability to savers: markets which lack these features are unlikely to function effectively in the interests of consumers. Below we explore the case for a more accountable system from both of these perspectives.

Responsible capitalism and responsible capitalists

A machine without an engine: Savers' role in better stewardship

Enhanced accountability to shareholders has been a key plank of recent attempts by policymakers to promote more responsible corporate behaviour in relation to issues like executive pay.[9] Yet, as we argued in our 2012 report 'The Missing Link', unless and until the intermediaries who control shareholder rights are the true servants of the underlying savers, there is a danger that such measures will fall short of the expectations being placed on them. During the 2012 'Shareholder Spring', popular scrutiny of shareholder voting did appear to focus minds and encourage asset managers to take a more robust approach - but such scrutiny is currently all too rare. There is therefore a need to extend the thinking behind recent reforms such as binding shareholder votes on executive pay, and apply the same accountability we expect of companies one step down the chain to shareholders themselves.

> *Without scrutiny from below, the Stewardship Code's 'comply or explain' mechanism risks becoming a machine without an engine - resulting in pressure to abandon this model in favour of regulation from above*

Indeed, recent efforts to promote more responsible ownership practices by institutional investors are already modelled on the existing corporate governance regime, but lack the element of scrutiny on which that regime is predicated. UK corporate governance relies heavily on the 'comply-or-explain' Corporate Governance Code which has been widely emulated in Europe and beyond.[10] This form of 'soft law' effectively gives shareholders, rather than regulators, the responsibility for enforcing good practice. Shareholders are the audience for companies' explanations under the Code, and are expected to challenge companies who give inadequate explanations for departing from its principles (although the extent to which they do so appears to be extremely variable).[11] The UK Stewardship Code, aimed at institutional investors, was introduced in the aftermath of the financial crisis to address concerns that they had behaved as 'absentee landlords', allowing banks to engage in excessive risk-taking.[12] It is explicitly modelled on and intended to complement the Corporate Governance Code. Again, this approach is now being copied in other jurisdictions.

But, as with companies, the 'comply-or-explain' mechanism relies on scrutiny from below. The Code makes clear that the intended audiences of institutional investors' disclosures under the Stewardship Code are their clients and beneficiaries.[13] Yet savers are not equipped or encouraged to play this role. This missing piece of the puzzle may help to explain why asset owner uptake of the Code has so far been disappointing. Without scrutiny from below, the Stewardship Code's 'comply or explain' mechanism risks becoming a machine without an engine - resulting in pressure to abandon this model in favour of regulation from above. The Business, Innovation & Skills Select Committee has already expressed disappointment at the slow pace of change in investor behaviour, and has called on the government to intervene if take-up of the Stewardship Code remains insufficient.[14]

By contrast, as one participant in our roundtable suggested, actively promoting accountability to the ultimate saver could positively influence not only institutional investors' behaviour but also that of company directors themselves. Instead of believing their duty is to shareholders in the abstract, represented by "a crude assessment of today's share price", they might begin to concern themselves more with creating real value for their real beneficial owners. In this context, not all profits are created equal: inflating short-term returns through risky financial engineering or by offloading the costs of environmental damage clearly serves ultimate owners less well than generating sustainable wealth by producing something of real social value.

Indeed, the key reason why many expected the rise of pension funds to herald a new kind of capitalism was that they represented ordinary people whose interests clearly extended far beyond the share price of individual companies in which they might happen to invest.[15] The disconnect between these ordinary people and the intermediaries who exercise shareholder rights may help to explain why these predictions have, by and large, failed to materialise.

Rehumanising investment

It is not only companies who think in terms of abstract shareholders rather than real human beings: so do institutional investors themselves. The duty to act in the best interests of the people whose money you manage is increasingly viewed in terms of a crude 'duty to maximise returns', with the people themselves either reduced to an archetypal 'rational economic man' - Lynn Stout's 'Platonic investor' - or, even more concerningly, written out of the equation altogether. US academic Steve Lydenberg has documented how fiduciary investors' duties are increasingly seen as being owed to 'the fund' or 'the portfolio' rather than to a group of real human beings.[17]

> Shareholder value thinking looks at the world from the perspective of a Platonic investor whose only asset is equity shares in one firm (say, BP), and whose only purpose and desire in life is to raise today's price for BP's shares by any means possible. But this Platonic shareholder does not exist. Real human beings own BP's shares.
>
> ***Lynn Stout, The Shareholder Value Myth[16]***

This dehumanisation of investment risks damaging savers' financial interests and eroding the ability of the investment system to allocate capital efficiently. Instead of a mechanism for linking the savings of real people with productive investments in real economic activity, investment becomes an abstract mathematical exercise, conducted as if portfolio performance exists in a vacuum and can reliably be optimised by following the dictates of objective models. The financial crisis showed how dangerous this can be: bankers put their faith in risk models which asserted that the events of 2007-08 were so spectacularly unlikely they should not be expected to occur over the entire lifetime of the universe.

> ***If policymakers want capitalism to have a conscience, capitalist institutions must be accountable to real human beings, and not only to an abstract ideal of profit maximisation***

The problem was not just that the risk models themselves were flawed, but that the inherent limitations of any model were ignored. As Keynes famously observed, investment is not just about risks which can be calculated, but about fundamental uncertainty: we don't know what is going to happen in the future, so we must have the license to use our discretion and common sense.[18] This means making qualitative judgements about the interests of real savers with holdings across the economy: for example, their interest in a stable financial system, which will certainly outweigh their interest in high short-term profits at individual banks; or their interest in avoiding the economic dislocation that would result from unmitigated climate change, which will equally outweigh their interest in high short-term profits at oil majors. Putting individual savers back into the equation could help to reconnect the financial world with the real world, thus better equipping it to serve savers' real economic interests.

Separately, the 'dehumanisation' of the investment system leads to the neglect of any interests that savers might have *outside* of the financial performance of the fund, such as their interest in a healthy environment, a stable economy or a cohesive society - or their ethical views (discussed further below). Accruing a pension is too often treated as an end in itself, rather than a means to the end of a secure and prosperous retirement. If policymakers want capitalism to have a conscience, capitalist institutions must be accountable to real human beings, and not only to an abstract ideal of profit maximisation.

An ethical marketplace

Finally, savers who feel connected to their money are more likely to see it as an arena for the expression of their values - not just in terms of where they invest (of particular relevance in defined contribution (DC) schemes, where savers generally have a choice of funds) but also in terms of how ownership rights are exercised on their behalf. To be clear, this is distinct from the issues of stewardship and responsible investment discussed above: although they may also involve the consideration of environmental, social and governance (ESG) issues, these approaches are usually motivated by a desire to maximise company value over the long-term. By contrast, 'ethical investment' approaches are usually understood as being motivated by purely moral considerations.

Thinking about the ethics of what you buy is now mainstream in relation to many if not most consumer goods. This is even beginning to extend into the world of finance with movements such as Move Your Money, sparked by the banking crisis, which encourages people to switch their bank accounts to more ethically responsible providers.[19] But when it comes to pensions, this has yet to break into the mainstream. This is not for lack of consumer interest, at least in theory. Research by the DWP found that nearly 70% of people who said they would make an active investment choice were interested in investing their pension ethically.[20] Yet the proportion of UK pension assets invested in ethical funds is just a tiny fraction of this, and many DC schemes still do not offer an ethical option.

Moreover, ShareAction's own research has found that ethical retail funds offered on the market often fail to reflect the modern consumer's priorities. While labour rights, human rights and environmental issues tend to top surveys of people's concerns, many funds continue to focus on avoiding 'sin stocks' like alcohol, gambling and pornography.[21] For whatever reason, the transmission mechanism between consumers' declared preferences and the products available in the market appears to be broken.

Of course, choosing a specifically ethical or green fund is not the only route through which savers' values can be reflected in their investments - and some do not have this option, for example in defined benefit (DB) schemes (and some DC schemes) where all savers' money is invested in the same funds. Despite numerous statements to the contrary from government and regulators,[22] there remains an overwhelming perception among such schemes that savers' ethical views cannot lawfully be taken into account. This attitude is typified by the response one pension saver received to an email they sent via our website in 2010: "The trustees have a legal duty to not only invest, but to actively seek the best possible financial return ... even if it is contrary to the personal, moral, political or social views of the trustees *or beneficiaries*." (emphasis added)[23]

In chapter 3 we consider the objection that matters of ethics are too subjective for institutional investors to act on, since the views of different savers are bound to conflict. For now, suffice it to note that it is precisely these issues where savers might have most to add. Fiduciary investors might be justified in preferring their own more expert view on technical questions of investment strategy, but they are not permitted to indulge their own ethical preferences when dealing with other people's money. The only ethical views they should take into account are those of the beneficiaries themselves.[24]

Efficient and effective markets

Acknowledging agency problems

Accountability of investment institutions should not only be of concern to those seeking to build a more responsible capitalism. Even if one follows Milton Friedman's view that "the social responsibility of business is to increase its profits", there are good reasons to think that a more accountable investment system is vital to the effective functioning of free-market capitalism.

> *It is curious that policymakers concerned about the behaviour of directors (whom they regard as agents for their shareholders) have attempted to resolve this simply by empowering a set of people who are also agents (institutional investors)*

Mainstream economic theory holds that markets made up of rational, self-interested individuals will automatically allocate capital efficiently. But, as economist Paul Woolley has pointed out, this breaks down if the decisions are being made by agents, rather than by the people whose self-interest is supposedly being advanced (the 'principals').[25] The so-called 'agency problem' has been discussed endlessly in relation to the behaviour of corporate managers; yet when it comes to investors, both academic theory and regulatory practice has tended to assume that institutional investors' behaviour will align with the interests of the savers whose money they manage. Analyses from Myners to Kay have repeatedly shown that this may not always be the case - and indeed, that investment agents face systematic pressures to act in ways that may not serve the underlying saver.

Of course, there are various ways to counter these pressures. But direct accountability of agents to their principals is an important one. It has certainly been treated as such by policymakers seeking to ensure that company directors act in the interests of their shareholders. Indeed, it is curious that policymakers concerned about the behaviour of directors (whom they regard as agents for their shareholders) have attempted to resolve this simply by empowering a set of people who are also agents (institutional investors). Few have seriously questioned the accountability of these agents to the underlying savers. And yet, if we want financial markets to operate efficiently - whether in relation to listed companies or any other assets - it is vital that these savers are able to assert their interests.

Making automatic enrolment work

The above considerations apply to the investment system as a whole, but accountability is if anything even more important when it comes to the pensions system. As we will explore in detail in chapters 2 and 3, pension savers currently have relatively few rights to information and participation. This is partly the result of law derived from private family trusts (as discussed below), and partly the result of regulations designed for a world dominated by final salary pension schemes - a world which no longer exists. Neither of these frameworks is fit for today's pensions system, particularly now that millions of people are being automatically enrolled into DC schemes. In this world, a paternalistic approach which denies savers a voice in the way their money is managed is likely to become increasingly unacceptable.

> *Pension savers currently have relatively few rights to information and participation. This is partly the result of regulations designed for a world dominated by final salary pension schemes - a world which no longer exists*

Of course, automatic enrolment works precisely by harnessing savers' inertia when it comes to pensions - but that is no reason for the regulatory framework to actively sustain this inertia. Indeed, it is increasingly dawning on policymakers and regulators that it makes for a unique and highly dangerous marketplace. This is reflected in recent debates on fees and charges as well as the DWP's decision to consult on new quality standards for auto-enrolment schemes.[26] It might be argued that the way to protect savers' interests is by ensuring that schemes are well governed on their behalf. But good governance and accountability are not mutually exclusive: on the contrary, as the Myners Report observed,[27] they are mutually reinforcing. The pensions market may never be dominated by active and engaged consumers - but the more consumers are active and engaged, the better the market will work. The UK should follow the approach taken by Australia in its recent review of the pensions system: protecting the rights of those who wish to engage, and guaranteeing good governance as a backstop for those who do not.[28]

A question of trust

Greater accountability to savers could also help to promote the trust in the system that will encourage people to keep saving. As the Kay Review of UK Equity Markets put it, "in the last five years, there has been a wide erosion of trust in financial intermediaries and in the financial system as a whole. This erosion is not the result of misplaced public perception... it is based on observation of what has happened."[29] The investment industry has not escaped this loss of trust: a recent survey by the CFA Institute found that only a third of UK retail investors trusted the financial services industry, and just 7% believed that investment firms "do the right thing"[30] (the comparable figure across all countries surveyed[31] was 53%). This suggests that trust in the UK investment industry is not just low, but dramatically lower than in other English-speaking financial centres.

> *"Greater accountability to savers could also help to promote the trust in the system that will encourage people to keep saving"*

In their Spring 2012 workplace survey, the UK's National Association of Pension Funds found that mistrust of the industry had overtaken affordability as the number one reason for planning to opt out of auto-enrolment.[32] Although opt-out rates have so far been lower than predicted, there is no room for complacency: it is clear that many people still feel uneasy about pension saving. As one participant in our roundtable argued, "With tight household budgets, it's distressing to think that money is going out and you don't know where it's going or what you'll get back." A 'bad news story' such as a mis-selling scandal could easily bring this unease to the surface, damaging not just participation rates but the popular legitimacy of auto-enrolment itself. From this perspective, greater openness to savers is very much in the interests of both the pensions sector and pensions policymakers.

Legal objections explored

'Direct engagement with savers undermines fiduciary responsibility'

Legal objections to the idea of empowering savers are generally based on outdated conceptions of trust law which have little place in the world of modern investment. In trust-based pension funds, the traditional passivity of savers is linked to paternalistic ideas about fiduciary duty: the trustees have been appointed to look after the interests of beneficiaries, and it is not the role of beneficiaries themselves to question their decisions. In turn, it is sometimes argued that direct engagement by savers would fundamentally undermine the basis of the fiduciary relationship, diluting the responsibility of trustees for their decisions. Again, this is somewhat at odds with the way we treat companies: directors have fiduciary duties to promote the success of the company, but nobody assumes that this precludes the need for them to be held to account for how they discharge this duty. On the contrary, we give shareholders extensive rights for this purpose.[33]

It is true that fiduciary law has historically treated beneficiaries as passive. However, this dates from a time when the trusts in question were mostly private trusts, with trustees responsible for bestowing the bounty of a patriarchal settlor. As one academic puts it, any "whining, whingeing" beneficiaries "are not intended to have much scope to complain" and are "expected to accept the decisions of their trustees as if decisions of family umpires".[34] An example of the way such assumptions have been imported into pensions law is the 'Londonderry Rule',[35] which states that trustees do not have to disclose to their beneficiaries why they exercised their discretion in a particular way. The rule evolved in the context of private trusts, with a view to avoiding personal embarrassment or family discord. This is clearly a far cry from the large institutional investors of today. Despite this, the English courts have sometimes applied the rule to pension schemes.[36]

> ***"Paternalistic ideas about trusteeship are particularly difficult to sustain in a world increasingly dominated by DC pensions, where savers bear all the investment risk, and where trustees' investment decisions have direct implications for their retirement income"***

Yet, as numerous scholars have pointed out,[37] modern pension funds have very little in common with traditional family trusts - not least because pension savers have paid for their benefits (either directly, or indirectly through employer contributions which are effectively deferred pay). As such, pension fund trustees arguably "need to have a different mindset from trustees of traditional trusts"[38] - one in which accountability to savers is an essential feature. Paternalistic ideas about trusteeship are particularly difficult to sustain in a world increasingly dominated by DC pensions, where savers bear all the investment risk, and where trustees' investment decisions have direct implications for their retirement income.

Nonetheless, it is sometimes argued that greater accountability risks undermining both trustees' discretion to make decisions and their sense of responsibility for those decisions. Indeed, this objection was raised by one participant at our roundtable. To be clear, we are not suggesting that savers should be given decision-making powers which conflict with those of trustees, or that trustees should be obliged to act on savers' wishes. Savers should have the right to express their views and to scrutinise the decisions made on their behalf. Trustees' discretion to decide how to respond to those views would be unaffected.

Numerous precedents, both in the UK and overseas, demonstrate that there is no conflict between this notion of accountability and the concept of fiduciary duty. Indeed, there are examples of fiduciaries being legally required to consult beneficiaries in various jurisdictions.[39] In a UK pensions context, employers and trustees with powers to amend schemes are required to consult with beneficiaries before making amendments on certain specified matters.[40] In some Danish funds (see case study on page 32), member delegates attend Annual General Meetings and even vote on the board's annual report. Boards can choose not to act on delegates' concerns - thus retaining their fiduciary discretion - but are expected to explain why.

RECOMMENDATION

Given the tendency to apply outdated ideas from private trust law to pensions, explicit legal clarification is desirable: (a) to confirm that fiduciaries can take beneficiaries' views into account when making investment decisions, and (b) to give beneficiaries the right to an account of decisions made on their behalf.

Practical objections explored

'Most people aren't interested in engaging with their money'

It is often argued that there is no demand for greater accountability by institutional investors: savers simply aren't interested. It is true that most people currently find investment alienating and unappealing: auto-enrolment, which works by harnessing the power of inertia, is predicated on this insight. However, this certainly does not mean that greater accountability is not possible or desirable. There are a number of reasons why.

Firstly, we should consider the possibility that savers are turned off by investment because of the way it is communicated rather than simply because of its intrinsic complexity. As research by NEST demonstrates, although people may be put off by the language of investment, this does not mean they are not interested in understanding where their money goes. On the contrary, it is one of two key questions people want answered before entrusting their savings to the market (along with 'what am I going to get back?')[41] One participant at our roundtable argued that the onus is on the industry to engage with savers about their money in a way which is meaningful and not off-putting.

The potential of this approach is illustrated by Heineken's DC Pension Scheme: following a concerted and innovative campaign to inform members about the new scheme, 95% of employees signed up voluntarily, with 97% of those making an active investment choice - an astonishing level given that in most schemes, roughly this many people do *not* make an active choice.[42] If other schemes could replicate this model, it could transform the pensions system from one characterised by inertia into something resembling an efficient market with active, engaged consumers.

As this shows, savers' current disconnection from their money is not an immutable fact. Indeed, pointing to this as a reason to oppose greater transparency and engagement creates something of a vicious circle. As long as the minority of savers who do ask questions about their money continue to be rebuffed or find it impossible to access relevant information, it is highly unlikely that they will persist or encourage others to do the same. Meanwhile, for those who are unaware that their savings are invested in major companies and that this carries with it shareholder rights, meaningful engagement is clearly impossible unless and until this awareness is raised.

> *"Savers' current disconnection from their money is not an immutable fact. Indeed, pointing to this as a reason to oppose greater transparency and engagement creates something of a vicious circle"*

Government can play a part in educating current and future savers about where there money goes: for example, given that most workers will now be auto-enrolled into workplace pensions, this should be part of the proposed new curriculum in personal financial education. This should be taught in a way which not only explains abstract concepts like risk and return, crucial though those are, but also makes this meaningful by explaining where the money goes and how it gives savers a stake in the economy. The same goes for communications encouraging people to opt into workplace pensions, whether from government, industry or employers. A culture of scrutiny in our capital markets, where savers recognise themselves as owners and feel empowered to act on this, is something that will have to be built and nurtured. The fact that this culture is currently absent is a poor reason for failing to start.

Of course, it would be naïve to suggest that all savers will ever take an active interest in their money. Many will still prefer to pay in their contributions and think no more about it. What matters is that this should be a choice rather than a necessity. Meanwhile, the active scrutiny of an engaged minority can provide an important function for the rest of the market by making institutional investors feel accountable. One participant at our roundtable pointed out that the vast majority of people never meet their MP, being content to restrict their democratic engagement to voting every five years, if that. Yet we would never accept this as an argument against political accountability - because we recognise the rights of those who want to engage, and the contribution they make to the health of the wider political system.

RECOMMENDATION

Government, employers and the investment industry should take active steps to educate current and future pension savers about where their money goes.

'Most people aren't capable of engaging with their money'

A related objection is the claim that investment is simply too complicated for the average saver to understand. They are therefore less well placed than their professional agents to determine what is in their best interests. Indeed, interference from uninformed savers could lead to those agents making worse decisions rather than better ones. As an aside, it is interesting to note that very similar arguments were made against the extension of the franchise. In a debate on the demands of the Chartists in 1842, Thomas Babington Macaulay declared that if the demand for universal suffrage were granted, "knowledge will be borne down by ignorance", and "we should see something more horrible than can be imagined - something like the siege of Jerusalem on a far larger scale".[43] Dire predictions about the consequences of spreading power to the ignorant masses are clearly nothing new.

> ***"Even if many savers cannot grasp information about the investment objectives of their scheme's emerging market debt portfolio, few would have trouble getting to grips with an explanation of how the scheme was engaging on executive pay"***

More seriously, many participants at our roundtable argued that investment is not so fundamentally complex that the average saver would not be able to engage with it intelligently given the right conditions. This is certainly true of matters concerning responsible investment and the exercise of shareholder rights, which are the focus of this report. Savers may not have the expertise to engage with complex decisions about asset allocation, but many will have well-informed views about the activities of the companies in which their money is invested, or about threats to their future wellbeing such as climate change. Separately, wider questions of social and environmental responsibility are clearly something on which savers are competent to express views. Indeed, while professional investors are appointed for their expertise in financial matters, savers themselves are uniquely qualified to say what their own non-financial interests are.

In this context, questions of stewardship are far from an irrelevant sideshow. Indeed, it is precisely these issues which can transform investment from a dry, abstract or intimidating concept into a tangible and engaging one. Even if many savers cannot grasp information about the investment objectives of their scheme's emerging market debt portfolio, few would have trouble getting to grips with an explanation of how the scheme was engaging on executive pay. Concrete examples of company stewardship enable savers to see the way their fund is protecting value for them, the impact their money is having on real companies, and its power to influence things they care about.

Conclusion

Making the capital markets more answerable to those who provide the capital is the missing foundation stone on which efforts to improve corporate governance and shareholder oversight should rest. It has the potential to promote both a more responsible capitalism and a more efficient and effective financial system.

Some of the objections to this vision contain a grain of truth: a culture of disengagement and outdated legal assumptions drawn from private family trusts are both genuine challenges. But they are just that - challenges to be overcome, and far from insurmountable. They are not fundamental objections to the principle of reconnecting savers with their investments. Moreover, the prize is one worth pursuing: a better functioning, more responsible and responsive investment system which is both more trusted and more trustworthy.

Chapter 2: Enhancing transparency

By 'transparency' we are not referring to the disclosure of reams of data, but to the ability of savers (and bodies acting on their behalf) to access meaningful information about where their money goes and how institutions are looking after their interests. This is fundamental both to making markets work well, and to facilitating healthy scrutiny where market discipline is inherently imperfect.

As in any market, transparency about investments can help make consumer pressure operate more effectively - for instance, as the '2020 Stewardship' report argues, clear, comparable information about institutional investors' stewardship approaches could drive demand for stewardship up the investment chain.[44] But the pension system is not a typical market: although pension schemes choose their asset managers, most consumers do not actively choose their pension provider, instead having it chosen for them by their employer. This is certainly true for the millions about to enter the system under auto-enrolment.

Transparency is therefore not only about giving people the information to make informed choices, but also about promoting trust, engagement and healthy scrutiny of decision-making precisely where savers do not have a choice. As well as providing the information to facilitate such scrutiny, it is also part of the process of education which will equip savers to use that information. In a system in which savers cannot easily move their money, it is all the more important that their agents are held to account: in the language of corporate governance, 'voice' matters more when people have limited ability to 'exit'.

Yet at present, UK savers' rights to information about how their money is being used are remarkably limited - and in our experience, institutional investors are sometimes reluctant to disclose information voluntarily. In this chapter we set out a vision of a more transparent investment system, deal with some common objections to this vision, and explore how the current UK situation measures up to it.

What would a more transparent system look like?

What do savers need to know?

We asked participants at our roundtable to list the key information which they felt should be available to pension savers about their investments, either as a matter of course or on request. There were a number of recurring themes in the answers given. Based on this input, we have identified a number of key areas where greater transparency is desirable:

- Where is the money - what assets is the scheme investing in?
- Cost, charges and value for money
- Performance against long-term investment objectives
- Management of long-term investment risks
- Approach to stewardship: how does the scheme seek to nurture value in companies it holds?
- Voting and engagement activity

The issue of transparency on fees and charges has received extensive treatment elsewhere,[45] and is not the main focus of this report. In the remainder of this chapter we therefore focus on the other areas identified, which have received much less attention from commentators and policymakers. We begin by assessing savers' current rights to information, before considering what would need to change to achieve transparency in each of the areas identified. We conclude by considering some common objections to the ideas raised.

The current legal framework

Pensions disclosure regulations

At the time of publication, the UK government was in the process of revising and streamlining the pensions disclosure regime,[46] which at present is spread across various different sets of regulations applying to occupational, personal and stakeholder pensions.[47] The disclosures required of different types of schemes are inconsistent and overlapping (and will remain so under the new regime). This means that simply understanding what information they are entitled to is a task beyond the resources of most consumers. In addition, there is no entity within the regulatory structure responsible for producing consumer-facing materials to help people understand and exercise their rights to information.

Summary of UK pensions disclosure requirements on investment

	Occupational & stakeholder pensions	Personal pensions
Investment policy	Must provide on request a copy of their Statement of Investment Principles (SIP).[49] Since 2000, this must include details of the scheme's voting policy and its policy, if any, on social, environmental and ethical issues.[50]	Must give all new members "a summary of the scheme's investment policy",[51] but this is not subject to any of the prescribed content required of a SIP. The DWP is currently consulting on whether to extend the SIP requirements to personal pensions.[52] Also required under FCA rules to prepare a 'key features document', which must include information about the product's aims and material risks.[53]
Annual reporting on investment matters	Must provide on request a copy of their annual report and accounts.[54] This includes an investment report, which must contain: • A review of the scheme's investment performance during the year and over the previous 3-5 years (schemes can choose the exact reporting period). • An "assessment of the nature, disposition, marketability, security and valuation of the scheme's assets". • Details of any investments made in contravention of the SIP.[55]	Must provide on an annual basis certain high-level information about the funds in which members' contributions are invested and the scheme's performance over the preceding 5 years.[56]

NB personal pension schemes may also be subject to general client reporting rules under FCA rules and European law.

The government's proposed changes to disclosure rules will remove those requirements on personal pensions which are deemed to duplicate FCA rules. However, the complexity of these rules is such that even we have been unable to ascertain with certainty which rules are relevant or whether they differ from the previous DWP regulations. This change could therefore make the system even more opaque and confusing. It also adds to the fragmentation of the transparency regime: different rules overseen by different bodies may well evolve in different directions, creating further discrepancies between types of pension and hampering efforts to pursue an overarching vision of a more transparent system.

A detailed analysis of the DWP's current disclosure requirements in relation to investment is given in the table opposite. In brief:

- All schemes are required to disclose a summary of their investment policy. In the case of occupational[48] and stakeholder schemes, this must include details of their policies on voting and on social, environmental and ethical issues, if any.
- Occupational and stakeholder schemes must also produce an annual report, including an investment report which gives an overview of the scheme's assets and investment performance.

The Stewardship Code

Asset managers are required by the FCA to disclose their commitment to the Stewardship Code, or, if they choose not to commit, the nature of their alternative business model.[57] However, no equivalent requirement is imposed on asset owners. Participants at our roundtable suggested that this was a discrepancy which should be rectified.

The Code itself,[58] which operates on a voluntary 'comply-or-explain' basis, incorporates various principles relating to transparency (as did its predecessor, the Myners Principles).[59]

Compliance with the Code requires institutional investors to publicly disclose:

- their policy on discharging their stewardship responsibilities (Principle 1);
- their policy on managing conflicts of interest relating to stewardship (Principle 2);
- their voting policy and voting records (Principle 6).

The Code also requires institutional investors to report regularly to clients or beneficiaries on stewardship and voting activity (Principle 7).

Gaps in transparency

The current disclosure regime contains a number of important gaps. Below we analyse these based on the key areas for transparency identified at the beginning of this chapter.

Where is the money?

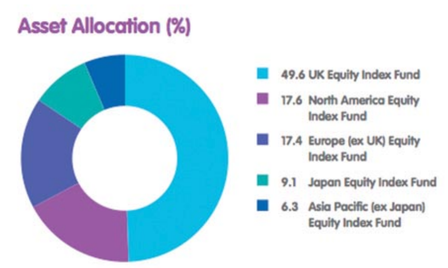
European law requires that pension savers who bear investment risk (i.e. defined contribution (DC) scheme members) must receive "detailed and substantial information on ... the actual investment portfolio."[60] However, there appears to be no regulation giving effect to this right in UK law. Occupational pension schemes' annual investment reports must include a high-level breakdown of the scheme's assets, but this usually only extends to asset allocation (i.e. the percentage of the portfolio held in shares, bonds, property etc). Such information is meaningless to all but the most financially literate savers, and does little to help savers understand the role their money is playing in the real economy. Naturally, this is a complex question, but a good start would be to provide savers with breakdowns of scheme assets by economic sector (for example, the percentage held in communications, consumer goods, financial services, or oil and gas). At present such information is provided by only a tiny minority of schemes (with one example being The People's Pension, see box below).[61]

Also useful would be information about individual companies held. The True & Fair Campaign has called for investment funds to be required to disclose their full portfolio of holdings on a quarterly basis, as is required of mutual funds in the US.[62] In our view, any such reforms should ensure that the underlying savers in institutional funds have the same rights to information as retail investors. At the very least, pension schemes should publish a list of their largest equity holdings (or in the case of DC pensions, the largest holdings in each fund available to savers), with more detailed information available to savers on request.

> *The existence of lengthy investment chains makes traceability of the actual investments underlying packaged products all the more important*

We have found that members who do make inquiries about specific investments often find it difficult or impossible to access this information. In particular, members are often told that the scheme cannot provide details of the underlying assets held through externally managed funds. One participant in our roundtable compared this to recent controversies in the food industry, which have highlighted the need to ensure traceability in lengthy supply chains to guarantee health and safety. Likewise, far from being a good reason to deny savers information, the existence of lengthy investment chains makes traceability of the actual investments underlying packaged products all the more important.

Example detail from 'People's Pension' fund factsheet



Sector Breakdown (%)

	Fund		Fund
Financials	22.9	Health Care	8.8
Consumer Goods	15.4	Basic Materials	7.0
Industrials	11.9	Telecommunications	5.0
Oil & Gas	10.8	Technology	4.9
Consumer Services	9.7	Utilities	3.6

Put another way, consumers have the right to know whether there is 'financial horsemeat' in their pension savings - whether this takes the form of complex mortgage-backed derivatives, or carbon-intensive assets which could become 'stranded' in the face of concerted regulatory action to tackle climate change.[63] This reinforces the case for information to be available publicly as well as directly to savers: this allows academics and consumer organisations with greater expertise to use the information to identify threats to consumer interests. Knowing where your money goes is a basic feature of an effective transparency regime, and this is a major gap in the UK system.

RECOMMENDATION

Pension schemes should be required to disclose a list of their major holdings on at least an annual basis. Savers should have the right to receive more detailed information on holdings on request.

Investment strategy and stewardship approach

Research by ShareAction[64] and others[65] suggests that pension schemes' Statements of Investment Principles (SIPs) are often 'boiler-plate' and give little meaningful insight into schemes' investment approach. In addition, the content of the SIP was prescribed long before the introduction of the Stewardship Code and does not fully reflect the growing consensus on the importance of shareholder oversight - including oversight of environmental, social and governance (ESG) issues - in protecting value for savers. There is a strong case for reviewing the regulations which prescribe the content of the SIP to ensure that they keep pace with current best practice, and that - whether through the regulations themselves or through accompanying guidance - schemes are encouraged to provide meaningful and specific insight into their investment approach.

RECOMMENDATION

The SIP regulations should be reviewed to ensure that schemes disclose their policy on managing ESG risks and their approach to stewardship. This should include a requirement to disclose whether they comply with the UK Stewardship Code, and if they do not, to explain why.

Performance against long-term investment objectives

Schemes are not obliged to report on how the Statement of Investment Principles (SIP) has been implemented, but only on specific investments made in contravention of the policy (a rarity, since policies are usually very high level). The Myners Review suggested over a decade ago that a strengthened SIP, setting out how the scheme's policy was being implemented, should be distributed to members annually, and that this "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".[66] In our view, this should be the role of the annual investment report, which should be published online and drawn to members' attention rather than only available on request.

Annual investment reports must currently include data about investment performance, but there is no requirement to include any narrative information contextualising that performance. The biggest and best pension schemes do include such narrative, but this is often jargon-filled and clearly not aimed at the average member. We examined the most recent available investment reports for the UK's top ten occupational pension schemes by assets under management. Of the eight schemes who made an investment report publicly available, only four included anything which linked the year's investment performance to events in the real economy. The remainder dealt solely with the performance of financial markets and were dominated by the jargon of benchmarks and indices.[67]

One participant at our roundtable suggested that schemes should have to state their long-term investment objectives in real world terms. Performance should then be reported in a way which tracks progress towards that goal - rather than in terms of short-term benchmark-relative performance, as is currently the norm. Some newer asset management firms, such as Nutmeg and RPlan,[68] are beginning to make use of the web to provide information in this way, but this is still very much the exception and has not permeated the pensions sector.

Management of long-term investment risks

Furthermore, unlike companies' narrative reports, pension schemes' annual reports do not have to contain any assessment of forward-looking investment risks and how they are being managed. Of the eight schemes whose investment reports we analysed, only two included any assessment of forward-looking investment outlook, with only one of these (BT Pension Scheme) giving any indication of what trustees planned to do about this. The remainder of reports were wholly backward-looking - despite the cardinal rule of investment that past performance is no guide to the future.

> ***"What matters most to the average pension saver is how their fund is seeking to create sustainable value, how successful this strategy is proving, and what this means for their retirement"***

In this respect, the regulations surrounding investment reports are something of an anachronism, designed for a world dominated by defined benefit schemes, and out of date even for these schemes. What matters most to the average pension saver is how their fund is seeking to create sustainable value, how successful this strategy is proving, and what this means for their retirement. Investment reports therefore need to have a long-term perspective and forward-looking focus which is missing from almost all investment reports at present.

RECOMMENDATION

The existing requirements for occupational pension schemes to produce an annual investment report should be amended to more closely mirror companies' narrative reports, focussing on (a) how schemes have implemented their investment policy during the year, and (b) how they are managing long-term risks to savers' investments. This requirement should also be extended to personal pensions.

Voting and engagement

The Stewardship Code is undoubtedly a positive force in promoting transparency on voting and engagement. However, it does have limitations. Firstly, the voluntary nature of the Code means that its coverage is not universal. Although the majority of asset managers now declare compliance with the Code, take-up has been much lower among asset owners. This means that its impact on transparency to the ultimate saver has been limited. The Code may have helped to make asset managers more accountable to asset owners, but has generally not yet made asset owners more accountable to the individuals whose money is at stake. According to our most recent research, only six of the top ten UK occupational pension funds disclose any voting information (with most of these only disclosing partial information), and only four disclose any information about engagement.[69]

Secondly, even where institutional investors do claim compliance with the Code, our research has found that the quality of disclosures varies significantly. For example, conflicts of interest policies are a particular area of weakness, with many asset managers not providing meaningful information on where conflicts might arise or how they manage them.[70] Similarly, headline figures stating that 65% of Code signatories now disclose their voting records[71] disguise wide variation in the actual information disclosed, from detailed breakdowns of individual voting decisions and reasons for controversial votes, to bald summary statistics on the percentage of votes cast for and against management, which provide the reader with little or no meaningful information.[72] Moreover, data from recent IMA surveys suggests that the upward trend in the percentage of signatories who disclose their votes appears to be levelling off: universal, comparable disclosure is highly unlikely in the foreseeable future.

> ***“The Code may have helped to make asset managers more accountable to asset owners, but has generally not yet made asset owners more accountable to the individuals whose money is at stake”***

The government has reserve powers to make such disclosure mandatory for all institutional investors, and in our view these powers should be exercised.[73] Voting disclosure is already mandatory for US mutual funds, and the American experience belies most of the arguments made against mandatory disclosure in the UK (see box on page 28). The burden of disclosure should fall primarily on commercial asset managers, with pension funds being permitted to simply signpost their asset managers' disclosures from their own websites or reports.

RECOMMENDATION

The government should exercise its reserve powers to make voting disclosure mandatory for institutional investors.

Embracing the internet age

The UK disclosure regime remains largely paper-based and puts the onus on members to request information such as annual reports. Although some (rather convoluted and confusing) requirements have been introduced to enable schemes to provide information online, the government has been reluctant to embrace the opportunities of web-based disclosure to make information available proactively and at low cost. In part, this stems from understandable concerns about the rights of those who may not have access to the internet, particularly the elderly. However, one damaging consequence of this is to exacerbate the reluctance to introduce new transparency rules, on grounds of cost. The potential of the internet to change how institutional investors communicate with savers is discussed further in chapter 4.

From information to transparency

Input from roundtable participants supported the following principles for ensuring genuine transparency, as opposed to merely the disclosure of large volumes of information.

- Objective data, such as major investments or voting records, must be disclosed in a comparable format, so that users can conduct like-for-like comparisons. The obvious parallel here is the remuneration reports which companies are required to prepare for their shareholders. The government's recent regulations have made the content and format of remuneration reports significantly more prescriptive, in order to ensure that information is provided in a clear, simple and comparable manner which shareholders can make use of.[86]

  Since the information to be disclosed is objective and factual, concerns about 'boiler-plating' do not apply. In addition, there is no obvious reason why greater prescription should translate into greater regulatory burden: if anything, setting out a clear template for disclosures should simplify the process for those disclosing.

- Qualitative information should be straightforward, accessible, engaging and thoughtful. Above all, it should be framed in a way which makes investment tangible for savers, for example by showing how the financial abstractions which currently dominate reports translate into businesses and events in the real economy. Participants contrasted this with the often dense and meaningless nature of much current disclosure.

- Information about investment, including stewardship activity, should be easily accessible - for example, webpages dealing with stewardship should be easy to find on the scheme website. ShareAction surveys have consistently found that such information is often buried in obscure places - or, in the case of asset managers, located on websites which are only accessible to users who certify as professional investors.[87] This means that, even where information is disclosed, it is often difficult or impossible for the interested saver to find.

Common objections explored

'Nobody will use the information'

It is often argued that mandating greater transparency about investment would be an expensive waste of time, since nobody is interested in this information. We have already argued (in chapter 1) that this argument is unconvincing. It could also be added that the audience for this information extends beyond consumers themselves to academics, consumer groups and public interest organisations acting on their behalf. One participant at our roundtable

CASE STUDY - VOTING DISCLOSURE IN THE US

Disclosure of voting records has been mandatory in the US for mutual funds (albeit not for pension funds) since 2003.[74] Funds must disclose details of individual votes cast, along with a description of the proposal and an indication of whether their vote was for or against management. The US experience is worth exploring in detail, since it provides an empirical precedent against which to assess common objections to introducing mandatory disclosure in the UK.

The main rationale for the rule's introduction was that voting decisions have "an enormous impact on the financial livelihood of millions of Americans", and that disclosure would "illuminate potential conflicts of interest and discourage voting that is inconsistent with fund shareholders' best interests".[75] Opponents of the rule argued that there was no evidence such conflicts existed, but subsequent research has borne out this idea: for example, one study of US mutual funds found that funds more enmeshed in "webs" of business ties were less likely to vote against management.[76]

As in the UK, the industry vociferously opposed the rule, complaining that the costs were excessive: as one author put it, "while providing no practical benefit to investors in their investment decision-making process, these new rules effectively impose onerous and costly obligations on funds and their advisers".[77] It was also argued that disclosure could distort voting decisions, either through 'hijacking' by special interest groups or by pushing funds to vote blindly against management to prove their independence. Conversely, it was suggested that disclosure could actually enhance conflicts of interest by making it easier for companies to identify rebels and restrict their access to senior management.[78] (However, this objection has been debunked by academics who point out that management already have access to voting information, as most companies do not have confidential voting, and in any case it is difficult for a large blockholder to disguise its votes.[79])

None of these predictions have been borne out. Disclosure has not crippled the competitiveness of the US mutual fund industry. Nor does it appear to have distorted decision making. Although there are still only a handful of empirical studies, evidence suggests that there has been no across-the-board impact on voting decisions as a result of the disclosure rule (i.e. no general trend towards more votes for or against management).[80]

Of course, it could also be argued that this means the disclosures have had no positive impact. However, this misses the point: one would not expect or want disclosures to lead to a mechanical rise or fall in support for management, but rather to a more considered and accountable approach to voting. And the US disclosure rule certainly has achieved a greater culture of scrutiny around voting decisions. Platforms such as FundVotes[81] and ProxyDemocracy[82] digest and publish aggregate voting data for the benefit of analysts, media, investors and the public. Civil society and public interest groups use voting information to highlight trends in investor voting on particular issues, such as political lobbying[83] and climate change.[84] Trade unions use the data to undertake regular surveys of funds' voting practices. Indeed, SEC filings have proved an invaluable resource for ShareAction when analysing votes at UK listed companies: because of the absence of any such requirement in the UK, this is often the only way for us to access relevant information.[85]

made the analogy with information about consumer goods: most consumers do not access the raw data, but they do access analyses by organisations such as Which? that enable them to make better decisions. Likewise, although few savers may take the trouble to trawl spreadsheets of voting information, in our experience there is a clear public appetite to have such information digested and presented in an accessible form. For example, our chart showing how major asset managers voted on controversial pay proposals in 2012 was widely shared on social media. The experience of the US (see box opposite) shows how a clear legal framework can help to facilitate this type of public discourse.

> *Although few savers may take the trouble to trawl spreadsheets of voting information, in our experience there is a clear public appetite to have such information digested and presented in an accessible form*

'More disclosure will create information overload'

It is a fallacy to equate greater transparency with disclosure of large volumes of complex information. This fallacy has to some extent been perpetuated by the industry's approach to disclosure, which often involves sending individuals dense and complex information. The House of Commons Work and Pensions Committee addressed this issue in its recent review of governance and best practice in workplace pensions, and expressed concern that "over-regulation" is sometimes used as an excuse not to simplify their pension communications. But, as the Committee noted, NEST has managed to produce simple and comprehensible materials whilst complying with regulations.[88]

This observation was echoed by participants at our roundtable, who suggested that much disclosure at present is designed to 'cover the backs' of those disclosing rather than for the benefit of the reader. As one (highly financially literate) person commented, "The information I get from my pension providers is incomprehensible and misleading." Our vision is not of a world where consumers are automatically bombarded with reams of dry and detailed information. Rather, it is of a world where institutional investors engage with savers in a way which is straightforward, accessible and above all, meaningful; where we make the most of the internet's potential to enhance transparency at relatively low cost; and where savers who do take a close interest in their money have the right to access more detailed information on request.

'The costs outweigh the benefits'

Finally, objections to greater transparency on grounds of cost are in our view unconvincing. Precise figures are difficult to come by, but those who already publish detailed information about investment and voting decisions privately say that the costs of such disclosure are negligible. In many cases (such as that of voting information) the data is already collated internally, and the only cost involved is that of uploading it to a website. In other cases (such as the publication of annual investment reports), disclosures are already a legal requirement, and our proposals would merely change the content and focus of these documents in a way which should not materially increase the burden of preparing them. Dark predictions were made by US mutual funds about the costs of mandatory voting disclosure (see box above), but - unsurprisingly when set in the context of a multi-billion dollar industry - the legislation appears to have had no significant impact on industry profits or consumer charges.

Conclusion

Savers' rights to information about where their money goes and how ownership rights are exercised on their behalf are currently patchy at best. In our view, these rights must be guaranteed - not least because we have direct experience of savers seeking information about their investments and being denied a response. Starting from first principles, we have sketched out a vision of the information savers should be entitled to and the policy changes needed to guarantee these rights. However, while policymakers can set a floor, clearly policy cannot mandate institutional investors to disclose information in a way which is engaging, innovative and accessible - as in the examples discussed in our best practice guide. It is to be hoped that, as scrutiny from savers becomes the norm, this kind of genuine commitment to transparency will become a source of competitive advantage for investment providers.

Chapter 3: Engaging and involving savers

Although transparency is an essential foundation, a truly accountable investment system needs more than this. Savers should also have the right to a say in what happens to their money: expressing their views when policies are developed, and scrutinising the decisions that are made on their behalf. As in other fields, a culture of scrutiny and healthy debate should help to sustain and improve the quality of decision-making. This principle is taken for granted when it comes to shareholders' ability to hold company directors to account for their decisions; indeed, it has been the cornerstone of recent policy to promote a more responsible capitalism. There seems no obvious reason why the same principle should not be applied to institutional investors themselves.

Such accountability could also help to create a 'culture of ownership' in which savers feel that their money gives them a stake in the economy, and have confidence that it is being invested in their best interests. As discussed in chapter 1, this in turn could help overcome the suspicion and inertia which pensions all too often inspire, turning investment from an object of mistrust into a positive activity.

We have already argued (in chapter 1) that this kind of engagement poses no threat to the decision-making power of investment fiduciaries. They would retain the discretion to judge how best to serve savers' interests; they would merely be expected to take into account those savers' views about what their own interests were, and to engage in dialogue and debate to justify their decisions. This would be an important step forward from the current situation, where most savers are disconnected from their money and the decisions made on their behalf are subject to few checks and balances.

> *"A culture of scrutiny and healthy debate should help to sustain and improve the quality of decision-making. This principle is taken for granted when it comes to shareholders' ability to hold company directors to account for their decisions"*

As in chapter 2, in this chapter we first consider what a more accountable investment system would look like, considering a range of possible policy interventions to help bring about this vision. We then address in detail some common objections to these proposals.

What would a more participative system look like?

Proactive participation: informing decisions

In a more accountable investment system, savers would be consulted and engaged in the development of investment policies - particularly on issues where the views of savers should be paramount, such as ethical investment policies (see chapter 1). Consultation can take many forms, from simply offering the opportunity to comment on a draft policy, to surveys and focus groups (as used by NEST in designing its investment approach)[89], to seminars and workshops as used by Danish fund PKA (see case study below). It need not necessarily mean the issuing of a formal consultation document soliciting written submissions: what matters is the general principle that savers' views are sought as part of policy development, through a process which gives all members an equal opportunity to have their views represented.

In our view, the investment system is currently so far away from this ideal that some form of policy intervention will be needed to catalyse the necessary cultural shift – for example, guaranteeing savers a right to be consulted about how their money is invested and how ownership rights are exercised on their behalf. Requirements for pension schemes to consult would not be without precedent: trustees are already required to consult the sponsoring employer when preparing or reviewing their Statement of Investment

Principles. Scheme members themselves have few rights to consultation but do have to be consulted before employers or trustees make changes in relation to certain specified matters, as noted in Chapter 1 (although these matters do not include investment policy).

One issue raised by participants at our roundtable was the need to ensure that the costs of any such intervention are proportionate to its benefits. A possible mechanism for this would be to give savers a right to be consulted, or to trigger a review of their scheme's investment policy, only if a certain threshold condition is met (i.e. either a certain absolute number of members, or a certain proportion of members, actively requesting this), rather than a blanket requirement on all schemes to consult. This would automatically ensure that the costs of consultation were only incurred where there was sufficient demand to justify them.

One possible problem with this approach is that it may not be sufficient to break the current 'vicious circle' of disengagement which prevails in the investment system as a whole. In order to build a culture of dialogue and debate about where our money goes, institutional investors

CASE STUDY: PKA, DENMARK[90]

Member engagement is much more widely accepted in Denmark than in the UK: most industry wide and professional pension funds have some kind of established mechanism for member involvement. Of particular interest are the 'Pensionskasser', a type of Danish pension fund owned and controlled by its members. These funds are obliged to account to members through annual meetings, usually through the election of delegates who attend and vote at AGMs and scrutinise the board. These delegates fulfil a somewhat different and complementary role to that of member-nominated trustees: their role is not to make decisions, but to engage with decision-makers on behalf of the membership at large. If the board chooses not to act on delegates' concerns, it is expected to explain why.

One of the most comprehensive examples of this system in action is PKA, the Danish healthcare sector fund, which administers five schemes with 250,000 members. PKA delegates are given two and a half days' intensive training to equip them with an understanding of pensions and investment, in order that they can ask intelligent questions and engage with debates about fund policy. They act as a point of contact between members and the board, and are consulted in the formulation of policy: for example, the scheme's Socially Responsible Investment policy was initially drawn up through a series of delegate seminars. This process identified a core of unacceptable investments - initially involving weapons, and expanded in 2005/06 to include tobacco - which the fund now screens out. It also showed that delegates were particularly interested in protecting labour rights and in seeking out socially or environmentally positive investments, which has helped to inform the fund's approach to engaging with companies.[91]

Delegates also engage in two-way dialogue with fund decision-makers, helping them to understand the fund's approach as well as informing it. For instance, delegates have been engaged in 'dilemma discussions', using role play to explore hot topics such as whether, when faced with revelations about the use of child labour in an investee company, PKA should stay and engage, or sell its shares. PKA reports that this has helped to build understanding and support for the fund's engagement-led approach among delegates who would previously have criticised it for not divesting.

may need to make the first move, positively nurturing savers' interest rather than merely responding where interest is already high. If the threshold were set too high, it could also place unreasonable bureaucratic obstacles in the way of savers seeking to engage, thus making the experience even more disheartening than it is at present. For these reasons, our preference would be for a general right to consultation, caveated if necessary to ensure that schemes were not obliged to incur unreasonable costs, rather than a threshold condition.

RECOMMENDATION

Pension savers should have the right to be consulted on the development of investment policies, and/or to trigger a review of their scheme's investment policy if a sufficient number of them request it.

Retrospective accountability: scrutinising decisions

An important complement to the right to a say in the formulation of policy is the ability to retrospectively hold boards to account for the implementation of policy. ShareAction works to promote such accountability by providing savers with opportunities to question their schemes about investment decisions that are of particular concern to them. For example, we maintain a tool on our website which makes it easy for savers to write to schemes with a query. Our aim is to provide the investment equivalent of online tools which connect voters with their MPs, such as WriteToThem.com. It is indicative of the level of disconnect between savers and their money that, in the absence of such tools, even asking a question is inaccessible to many people. We occasionally receive enquiries from savers whose scheme is not listed on our database and who are at a loss to know how to raise an investment issue with their provider.

Even those who do manage to contact their funds, either through our website or on their own initiative, often receive disappointing responses. Our 2012 report '*The Missing Link: Lessons from the Shareholder Spring*' analysed responses to emails sent about shareholder voting on executive pay, as part of our 'Your Say on Pay' initiative.[92] Although a small minority provided detailed and helpful responses, we found that most did not answer the specific question posed - and many appeared not to answer at all. This echoes the findings of a similar analysis of responses to emails sent through our website in 2010, asking how schemes intended to vote on shareholder resolutions at BP and Shell concerning the financial risks of their tar sands projects. Here, only 15 of the 43 responses analysed provided any substantive response to the question asked, and only 7 of these confirmed how the scheme or its fund manager intended to vote.[93]

Indeed, a striking aspect of this particular initiative was the hostility displayed by some schemes to the idea of being scrutinised by their members, with one trustee memorably declaring that whoever had encouraged savers to send the emails "should be taken out and shot". As discussed in chapter 1, this may be down to the application of paternalistic assumptions from private trusts, reflected in the fact that trustees are currently not legally obliged to give reasons to beneficiaries for their decisions. Changing this state of affairs is an essential prerequisite for building a more accountable investment system.

RECOMMENDATION:

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

Another important mechanism for retrospective accountability is the opportunity to question decision-makers in face-to-face meetings. Listed companies are obliged to hold Annual General Meetings to account to their shareholders, but no such requirement is placed on institutional investors. In some ways, this is strange: the case for such an accountability mechanism is if anything stronger in the case of investments, particularly where pensions are concerned. Few shareholders have their entire life savings invested in a single company (indeed, company AGMs are disproportionately attended by the tiny minority of pensioners who do rely on income from shares in a small number of companies). Yet many pension savers are reliant on a single fund for their wellbeing in retirement.

> ***“Listed companies are obliged to hold Annual General Meetings to account to their shareholders, but no such requirement is placed on institutional investors”***

A small number of pension funds (for example, BT Pension Scheme) do voluntarily offer their members the opportunity to question the board at face-to-face meetings, but this appears to be the exception rather than the rule. One trustee we spoke to whose scheme does hold such meetings said that they were extremely valuable, not just for members but also for trustees: she personally found that the experience “focussed minds” on the needs and priorities of the members in a way which the day-to-day minutiae of decision-making may not do. She added that, even for a relatively small scheme, the costs of organising such meetings were minimal. Some larger overseas schemes, such as CalPERS in the US[94] and ATP in the Netherlands,[95] organise ‘roadshows’ to allow members in different geographical areas to engage - and, in the case of CalPERS, open board meetings which are frequently attended by upwards of 100 people.

The precise format should be up to individual schemes to decide based on their circumstances, but in our view, some form of face-to-face meeting held at least once a year should be the minimum expected. To be clear, we are not suggesting that such meetings would be sovereign decision-making gatherings, as company AGMs are: this would indeed clash with trustees’ fiduciary responsibilities. The problem of decisions being made by ‘those who turn up’ would also be more acute, since the kind of remote voting systems used for company AGMs could be costly to administrate. Instead, meetings would have an advisory function, acting as a forum for scrutiny of board decisions and strategy by savers. There is no reason why meetings could not incorporate advisory votes: the PKA case study illustrates how this could work.

RECOMMENDATION

Like listed companies, pension schemes should be required to hold annual meetings giving savers an opportunity to scrutinise the decisions of the board.

Direct representation: member-nominated trustees

This report is primarily concerned with opportunities for savers at large to engage with decisions about their money. However, direct representation of savers on decision-making bodies themselves is clearly an important accountability mechanism, and can also help to connect savers more closely to the bodies entrusted with their interests. In our view it is important that such representation is seen as part of this wider framework, and not as a substitute for direct engagement by savers as a whole. Our conversations with member representatives suggest that many are uncomfortable with the idea that they hold sole responsibility for communicating with members and ensuring their views are listened to, believing that this should be the responsibility of the whole board.

> *When evaluating claims that savers will not make use of rights to participate, it is interesting to note that similar arguments were made against the introduction of member nominated trustees*

In the UK, member-nominated trustees (MNTs) were introduced for trust-based pension schemes following the Robert Maxwell scandal, on the basis that direct member representation would help to protect member interests. The TUC has argued that MNTs "tend to have better links back to the scheme membership than employers and can communicate clearly with colleagues about pensions, and take into account member interests and priorities in determining strategies for the pension scheme."[96] Occupational pension schemes are now required to have at least one-third MNTs,[97] and the government has reserve powers to increase this to 50% (a more usual threshold in other countries which provide for member representation, such as Australia, Belgium, the Netherlands, Norway, Sweden, Italy, South Africa and Japan).[98]

When evaluating claims that savers will not make use of rights to participate, it is interesting to note that similar arguments were made against the introduction of MNTs: some predicted it would be impossible to find enough members to fill the roles. A 2008 TUC study found that this has rarely been a problem in practice.[99] However, the same study found that, of 1161 trustees surveyed, only 11% were women, only 1% were under 34, and less than 1% were from ethnic minorities. The researchers concluded: "Overall the picture is of trusteeship as being dominated by white men over 45."

Encouraging greater diversity on trustee boards, and ensuring that all members are equally encouraged to apply for MNT roles, must be part of any agenda for empowering savers.

Of greater concern is the fact that the right to direct representation on boards is confined to certain types of pension saver. Some trust-based schemes are exempt (such as multi-employer 'master trusts', provided they meet certain conditions)[100], and contract-based schemes are not subject to any parallel requirement. These two types of scheme are increasingly dominating pension provision, meaning that board-level representation is a luxury enjoyed by a dwindling proportion of pension savers. The rationale for this discrepancy is presumably that member representation is less straightforward when the members concerned do not all work for a single company. However, this problem is clearly far from insurmountable.

> *Board-level representation is a luxury enjoyed by a dwindling proportion of pension savers*

For example, NEST is obliged to maintain a Member Panel with a consultative role in decision-making.[101] Vacancies are openly advertised through the NEST website and any member can apply to join.[102] The selection of panel members then follows a standard recruitment process operated by NEST. Panel members are sought from a range of industries and backgrounds and have a remit to represent the views of NEST members. Although the panel is not part of the board and does not have decision-making powers, it does illustrate that the selection of member representatives in large, disparate multi-employer pension schemes need not be overly arduous. This model could equally be applied to board-level appointments in other schemes. The government is currently considering the introduction of governing boards in contract-based pension schemes to replicate the best of trust-based governance.[103] Representation of savers should be on the agenda in any consideration of what such boards might look like.

RECOMMENDATION

Contract-based pension schemes should be required to include some form of member representation in their governance, in the same way that occupational pension schemes are required to have member-nominated trustees.

Building democratic structures

Finally, in a truly accountable investment system, the features discussed above - proactive engagement, retrospective accountability, and direct member representation - would be nurtured and facilitated by institutions which 'design in' accountability to savers. It is interesting to note that the case study of PKA discussed above is built on such a structure: the Danish 'Pensionskasser', owned and controlled by its members. There is no exact equivalent of this structure in the UK, although not-for-profit financial mutuals may offer the closest parallel. Large trust-based schemes, opened up to members through the reforms set out above, could also offer a starting point for the evolution of such institutions.

> ***Culture is not immutable: doing things in new ways can itself help to create and nurture new cultural norms***

Some participants at our roundtable raised the interesting question of whether the Danish model is transferable to the UK, or whether it is rooted in a fundamentally more consensual and less adversarial culture. As one participant put it, "In Denmark, everything's democratic." There may be some truth in this: as we have argued throughout this report, a cultural shift will be needed to make the capital markets truly answerable to those who provide the capital. But culture is not immutable: doing things in new ways can itself help to create and nurture new cultural norms. Moreover, culture is shaped to a large extent by the structures in which people find themselves. For example, it is argued that some of the problems with bank culture exposed by the financial crisis and, more recently, the LIBOR scandal can be linked to the way American investment banking culture has taken hold in large financial conglomerates. This is one argument for structural reforms to separate retail from investment banking. In the investment industry too, it is worth examining which institutional structures support the kind of culture we wish to build, and how such structures can be promoted.

RECOMMENDATION

Government should explore ways of promoting institutional structures which 'build in' accountability to members.

Common objections explored

Most objections to the idea of taking account of members' views when setting policy are rooted in the idea that it is simply not possible to reconcile the views and interests of a diverse group of people. The legal and practical aspects of these arguments are explored below.

'Funds will be hijacked by a vocal minority'

A common concern about giving savers the right to express their views is that this will lead to decisions being hijacked by a vocal minority. This was expressed by one participant at our roundtable as the problem of "how you weigh the interests of those who remain silent." Investment fiduciaries have a duty to treat all their beneficiaries impartially. In our view, far from being an argument against taking savers' views into account, this duty provides a safeguard against precisely these concerns. Input from savers can inform decision-making, but need not determine it. The role of fiduciaries is to weigh this input against other factors - including the interests of the silent. The alternative is to deny all savers any voice in the management of their investments. In our view, it is a highly impoverished understanding of the duty of impartiality which requires all beneficiaries to be ignored equally.

It is also worth noting that this problem is not unique to the investment sphere: it is important to avoid inadvertently setting a higher bar for ideas about involving savers than we do for participation in other walks of life, simply because these ideas are new and experimental. Not everybody participates in politics, but we do not say that this makes democracy illegitimate: what matters is that everybody has an equal *right* to participate. Likewise, the weight of responses to government consultations is skewed towards those with the resources to respond, usually the industry being regulated rather than those affected by its activities. As with investment fiduciaries, part of the role of government in such cases is precisely to "weigh the interests of those who do not speak": politicians and civil servants are expected to strive to act in the public interest. More to the point, few would give this as a reason to abolish consultations: on the contrary, most would argue that the solution lies in encouraging more participation, not less.

> ***In our view, it is a highly impoverished understanding of the duty of impartiality which requires all beneficiaries to be ignored equally***

'Different savers have irreconcilably different views'

A related objection is that acting on savers' views is simply not practically possible. The issues on which savers have most standing to contribute - for example, responsible and ethical investment - are also those which are most subjective. Even if schemes secured engagement from all members, and not just a vocal minority, there would never be enough consensus to translate this input into a coherent policy.

However, trustees' duty of impartiality does not require them to identify a complete consensus before they can act, nor does it paralyse trustees from acting where beneficiaries have different interests. Rather, it exists precisely because savers will inevitably have different interests which need to be balanced. This is no less true of the financial decisions made by trustees on a routine basis: for example, the financial interests of younger beneficiaries with longer time-horizons will differ from those of older beneficiaries, and it may not be possible to devise an investment policy that optimises the interests of both. But no trustee would throw up their hands and say that this made it impossible to devise any investment policy at all. What matters is that in doing so, trustees "[hold] the scales impartially between different classes of beneficiaries",[104] and that the interests of some are not privileged at the expense of others.

This is illustrated by the landmark case of *Cowan v. Scargill*, in which a group of union trustees, led by Arthur Scargill, sought to exclude from the mineworkers' pension scheme all investments overseas and in industries competing with coal. Among the judge's reasons for ruling against the union trustees was that this would have been a breach of the duty of impartiality: only beneficiaries still employed in the coal industry could even potentially have benefitted from the policy, whereas it would have entailed a significant financial loss to the detriment of all beneficiaries.[105]

This case is widely interpreted as an absolute prohibition on funds seeking to take account of beneficiaries' non-financial interests or ethical views (although it is often overlooked that the investment policy in question was not an 'ethical' one at all, but one designed to protect the coal industry). However, reflecting on the case in a subsequent paper, the judge speculated that a policy adopted on an 'other things being equal' principle would be "by no means a like case": in other words, if the views of one group of beneficiaries could be accommodated *without* harming the financial interests of others, this could well be "for the benefit of the beneficiaries at large."[106]

Of course, this is easier in defined contribution (DC) schemes where savers have a choice of funds: there, for example, offering an ethical fund which delivers lower returns does not affect the interests of those who do not choose to invest in it. However, even within default funds, or in defined benefit (DB) schemes where all savers are invested in a common fund, ethical preferences could still be accommodated if this was not anticipated to have a material impact on financial performance.

In Scandinavia, it is relatively common for funds to have ethical investment policies developed on this basis.[107] The legal position in these countries is comparable to the UK's: what is different is the cultural attitude to the legitimacy of taking into account savers' views and values.

Conclusion

Empowering savers to have a say in what happens to their money, and to scrutinise and question those who make decisions on their behalf, is far from an unrealistic pipe dream. In this chapter we have given examples of UK pension schemes who are taking their first steps in this direction, and of overseas funds where engagement with members is simply part of the furniture. We have also analysed and rebutted claims that it is impractical or even unlawful to listen to savers' views about their own money. Yet there is a long way to go if we are to make such engagement the norm for UK pension savers. The recommendations in this chapter are intended to provide a starting point for this journey.

CASE STUDIES - ACTING ON MEMBERS' VIEWS

The idea that acting on savers' views is rarely or never practical is not borne out by the experience of those who have tried. This is not to say that members do not disagree: **PKA** (see case study above) say that this was one of the key challenges they had to overcome when developing their member-led ethical investment policy. But PKA's experience also demonstrates that it is often possible to identify common trends or themes, particularly among groups of beneficiaries who share something in common, as members of occupational pension schemes often do. In the UK, the recently-launched **Trade Union Share Owners** group, which pools the shareholder voting activities of trade union pension schemes, has developed a voting policy which reflects the fact that its members - almost by definition - care about labour rights and employee engagement.[108]

Common ground can be found even in large pension schemes whose members do not work in the same industry. For example, **NEST's** research into its target demographic found that they were highly risk-averse relative to the general population.[109] This finding has been used to inform the scheme's investment strategy to ensure that members are not put off saving altogether by early losses. Similarly, NEST's voting policy incorporates the principle that "the lowest paid in the company should be paid at least a living wage". In addition to the business benefits of paying living wages, this reflects the fact that NEST exists primarily for low-paid workers who are disproportionately likely to be affected by the problem of low pay.[110]

Chapter 4: Harnessing new technology

The rise of the internet has created huge possibilities for disintermediation in almost every walk of life. Both the technology to connect with sellers directly and the facts to inform good choices are now at most consumers' fingertips. This development has transformed many industries: people research and book their own holidays rather than relying on travel agents, exchange second-hand goods directly on eBay, and so on.

> *Far from bringing savers closer to their investments, financial innovation has if anything tended to drive them further away*

But when it comes to investment, technology has not yet resulted in a more streamlined and less intermediated industry: instead, as the Kay Review noted, the chain of intermediation has become ever longer and more complex.[111] Far from bringing savers closer to their investments, financial innovation has if anything tended to drive them further away. Whether it be "socially useless" derivatives, or high-frequency trading based on complex algorithms, recent innovations have made the business of investing ever more complex, to the point where it is widely assumed to be beyond the understanding of the layperson.

It is only relatively recently - with the rise of peer-to-peer lending and crowd-funding platforms - that the trend towards disintermediation has begun to manifest itself in financial services. Such innovations have been widely hailed as having the potential to 'democratise finance', giving people more control over their money, linking lenders with borrowers and investors with businesses. But the sector is still nascent and has yet to move into the territory occupied by tax-incentivised pensions and other long-term savings vehicles. Moreover, the potential of the internet seems to have made less impact on the pensions market than on other mainstream financial services. While some pension providers give savers information about their fund through easy-to-use online accounts, this is very far from becoming the norm in the way that online banking has.

In this final chapter, we explore the potential for web-based technology to bring savers closer to the businesses in which their money is invested, and to spread control or influence over the exercise of shareholder rights more widely among those whose capital is invested in listed companies. We consider both the potential to reshape relationships within existing investment vehicles, and the potential impact of new and innovative models of investing on these established players.

Reshaping existing institutions: the voting chain

One area where technology might have been expected to bring benefits is in the exercise of shareholder voting rights. In his book 'The New Few', Ferdinand Mount envisages a world where savers have much more influence over the way voting rights are exercised on their behalf.[112] There appear to be few if any technological barriers to the realisation of this vision. Yet it is a very far cry from the current reality. For example, the average pension saver is separated from the exercise of shareholder rights attached to their investments not just by their pension scheme, but by asset managers, fund-of-fund managers, custodian banks, proxy voting services, and many others. Indeed, having a say in the exercise of shareholder rights is a luxury often not enjoyed by pension funds themselves, let alone the individual savers they represent. Even individual investors with their own personal portfolio of stocks may find it difficult to exercise the voting rights attached. Why is this?

Legal factors

One reason may lie in the legal structures through which most shares are now held. Firstly, pension savers are usually not the legal owners of their investments. In trust-based schemes, no single beneficiary has an identifiable share in any particular investment, although in most cases the beneficiaries collectively are effectively the beneficial owners of assets held on their behalf. In pension schemes run by insurance companies (i.e. all contract-based schemes and some trust-based), the insurance company is the beneficial owner: the policyholder owns only their rights under the contract with the company.

> *"Companies' share registers read as a 'Who's Who' of City firms, and give little or no insight into the underlying owners"*

Secondly, even if pension schemes were inclined to consult with savers about the exercise of shareholder rights, they themselves increasingly do not hold the legal title to their investments either, and thus may not have control over the way votes are cast. As the Kay Review noted,[113] it has now become the norm for investors to hold shares through nominee accounts. (This applies to individual as well as institutional investors: most execution-only brokers require individual clients to hold through nominee accounts, and this is also a requirement for ISAs.) This means that the owner of the capital is not the legal owner of the shares, but the beneficial owner. The legal title to the shares - and, by extension, the shareholder rights attached to them - is held by asset managers or custodian banks. However, beneficial owners do retain some rights, such as the right to file shareholder resolutions.[114] This suggests that legislation could, at least in theory, overcome some of the disadvantages experienced by holders of nominee accounts.

On top of this, many investments are made through pooled funds or unit trusts, where the underlying investor purchases units of the fund rather than individual shares. Voting rights are controlled by fund managers, who rarely allow their clients to separate out their 'share' of the fund for voting purposes. Taken together, all of this means that the question of who the real 'owners' are, and to what extent they should have control over the exercise of voting rights, is legally complex.

This has a number of consequences. One is to distance and disconnect companies from their true owners: the Kay Report expresses "regret that equity markets have evolved in a way which diminishes the sense of involvement which savers enjoy with the companies in which their funds are invested,"[115] and recommends that the government explore ways to enable individual investors to hold shares directly via an electronic register. Another is to make company ownership extremely opaque. Companies' share registers read as a 'Who's Who' of City firms, and give little or no insight into the underlying owners. This means that savers cannot find out if their money is invested in a particular company, and companies themselves may not know exactly who their 'real' investors are.

Practical possibilities

So what can be done to spread influence over voting rights more widely? It is important to note that, although the present legal situation limits the rights of ultimate 'owners' to have a say in the exercise of shareholder rights, there is no legal impediment to pension schemes and asset managers granting this on a voluntary basis. The exact shape of this might vary according to the type of investments held - some possibilities are explored below:

- ***Individual investors*** can and should be given the right to vote their shares even if they hold through nominee accounts. Some brokers

CASE STUDY: BREWIN DOLPHIN'S 'VOTE YOUR SHARES' SERVICE

Private client investment managers Brewin Dolphin offer an online service enabling individual investors to vote their shares.[116] The service is freely available to all clients in nominee accounts - a total of 130,000 investors with £30bn of assets invested. Clients can view upcoming votes and submit their voting instructions online. Brewin Dolphin then votes its shares in line with clients' wishes where instructed, voting the remainder of the shares according to its house position and then publishing the votes cast.

This service is not unique - similar tools are offered by some other brokers and investment managers. But, to our knowledge, no equivalent service is available to savers who invest through pooled investment funds or pension schemes. Yet according to staff at Brewin Dolphin, the technology involved is far from complex or costly: the system was developed in 1986 and could easily be adapted to other types of fund.

and asset managers already offer this service (see case study above).

- Identifying and separating the voting rights of investors holding through ***pooled funds*** is less straightforward but far from impossible: some asset managers do allow large clients such as pension funds to instruct on the votes attaching to their portion of the fund, and in our view this should be the norm. In addition, pooled funds could very easily use the internet to poll clients at large on particularly controversial votes or issues, with each client having a number of votes corresponding to the number of units held in the fund. The results of these polls could either be used to inform the 'house' voting position on an advisory basis (with managers publishing their voting decisions to facilitate scrutiny after the fact), or to split the fund's votes on a proportional basis.

- The status of ***pension savers*** is somewhat more complicated, particularly in trust-based schemes where any ability to instruct would arguably undermine trustees' fiduciary duties. However, again there is no reason why a pension scheme could not use the internet to poll their members on significant or controversial votes, using this to inform their own decisions. Where pension schemes do not seek to instruct their fund managers on individual votes, online polls could be used to inform the fund's general voting policy, as part of the kind of consultative approach discussed in chapter 3.

Overcoming barriers

Thus, neither law nor technology presents any insurmountable barrier to a more direct connection between savers and the shareholder rights attached to their investments. Rather, the problem is a lack of incentive for anyone to develop such services. Indeed, many large asset managers are actively resistant even to pressure from large pension fund clients to be allowed to give instructions about the exercise of voting rights. One possible reason for this is the clout enjoyed by asset managers who control large blocks of votes: managers are understandably reluctant to see this influence diluted by ceding control over voting policy to clients. It is argued that further fragmentation of voting rights would make companies harder to control and less subject to influence.

But it is important to remember that the influence wielded by large asset management

> *It is important to remember that the influence wielded by large asset management houses comes not from their own money, but from other people's*

houses comes not from their own money, but from other people's. The legitimacy of that influence should rest on their accountability to those people, not their ability to successfully resist accountability. Indeed, this perfectly illustrates the paradox that the 'democratisation' of ownership has in practice led to the concentration of power in a small number of unaccountable financial institutions. Asset managers should see the dispersal of this power not as a threat, but as an opportunity to reassert their legitimacy in the eyes of the public.

It must be acknowledged that Brewin Dolphin has not seen mass uptake of its tool: client voting tends to be greatest where companies have been subject to media coverage, as with 2012's votes on executive pay. However, uptake might be expected to rise if a similar model were applied to pooled funds or pension schemes in the ways discussed above. Because the members of collective funds are by definition all invested in the same stocks, it would be relatively easy for funds to conduct online polls regarding particularly significant votes and to proactively inform clients that these polls were taking place - for example through email alerts. Clients could then simply respond to alerts that interested them with a few clicks of a mouse. By contrast, individual investors must wade through swathes of routine votes to identify and react to the most important votes for their unique portfolio: a much more onerous task.

Is this then another example of the 'chicken and egg' nature of efforts to empower savers, whereby demand for participation cannot grow in the absence of proactive engagement from providers, which in turn will not grow in the absence of that demand? Or are there other ways in which interest from savers can be kick-started? Some tools are already being developed which use new technology to help savers navigate the mass of voting data and identify crucial votes on which they might want to have say (for examples, see box opposite). In 'The New Few', Ferdinand Mount argues that civil society also has a role to play in galvanising savers' interest in the power of their money:

"Pressure groups with a particular interest in certain issues - the low-paid, carbon footprint, mega bonuses - may offer critiques of [fund] managers. Some shareholders, who have better things to do than monitor companies all day long, might be enabled to switch their proxies to one of these ginger groups, who could then come to command an extensive body of support... There is no reason to suppose that, with the aid of new technology, individuals should not be able to band together to make their voices heard in serious questions of company management."

Although often regarded with suspicion by institutional investors, in our view such activities should be embraced as part of building a 'civil economy' in which people feel that the impacts of their money are as important as those of the consumer goods they buy. There is no reason why NGOs should not provide a conduit for like-minded individuals to express their views, in the financial arena just as they do in the political and - increasingly - the economic arena.

RECOMMENDATION

Government should explore ways to make the shareholder voting chain more responsive to the wishes of individual savers, and should encourage institutional investors to experiment with innovative ways of achieving this.

CASE STUDY: PROXY DEMOCRACY AND MY SHARES

In addition to publishing information about how mutual funds vote (see chapter 2), US website ProxyDemocracy enables individuals to track companies they are interested in, receive alerts for upcoming votes, browse past votes and see how other investors plan to vote. These services are primarily aimed at individual shareholders trying to decide how to exercise their voting rights; however, they could also provide a foundation for bringing savers closer to the voting decisions made on their behalf by pension funds and other institutional investors.

In the UK, the closest parallel to ProxyDemocracy is the recently-launched MyShares smartphone app, developed by Manifest and Proxycensus.[117] This app enables individuals to track upcoming AGMs at particular companies, and to view Manifest's own analysis highlighting contentious or significant votes. This illustrates the potential for innovative use of new technology to make the concept of share voting much more accessible to individuals with limited time or expertise.

Challengers to existing institutions

As well as reshaping relationships within conventional investment vehicles, it is worth considering the possibility that web-based technology might lead to the emergence of radically new, less intermediated models of investment. If such models began to offer a serious challenge to established market players, this could conceivably strengthen the currently weak incentives for existing providers to innovate.

Peer-to-peer lending and crowd-funding have been successful in part because they bring people closer to real businesses. For example, BankToTheFuture, a crowd-funding platform which enables people to take equity stakes in start-up businesses, promotes itself as allowing people to be part of creating a new economy, investing directly in things which "create jobs" and "make the world a better place", rather than in abstract financial instruments.[118] The ability to communicate directly with the companies you fund and stay up to date with their news is part of the service, and part of this model's appeal. The success of such models demonstrates that there is an appetite for this kind of direct connection - whether because of the loss of trust in financial institutions engendered by the banking crisis, or because of the desire to see one's money making a positive social contribution.

> *"Peer-to-peer lending and crowd-funding have been successful in part because they bring people closer to real businesses"*

At present, these models are largely focussed on investment in start-ups, and are thus competing primarily with venture capital. Online businesses are beginning to emerge targeted at retail investors and competing with existing retail investment funds, but these do not yet offer a direct equivalent of pension funds or other long-term savings vehicles which enable the investment of accumulated savings built up through regular contributions. However, those we spoke to within the sector suggested that this would be its next evolution. In practice, not all of these new providers mirror the directness of peer-to-peer lending, but they do showcase the potential for innovative use of technology to offer people a closer connection to their money. Although many come from the world of ethical or sustainable finance, some of the distinctive features of their approach have applications beyond this, as we consider below.

Calling the shots: can savers really direct their own investments?

At its most radical, the vision of these innovators is one in which savers invest directly in real projects and businesses, choosing the ones they want to support with a minimum of financial intermediation. Relevant examples include Ethex and Abundance Generation (see box). Whether such models offer a serious alternative to the current pensions system is debatable. Self-Invested Personal Pensions (SIPPs), designed to offer savers autonomy over where they invest, are in practice only available to a small minority of savers. Most employees must join the pension scheme chosen by their employer in order to receive employer contributions, and are not given the option of putting these contributions into a SIPP. Auto-enrolment is therefore likely to inhibit the growth of these nascent alternatives. One possibility is that, as these platforms become more sophisticated, defined contribution (DC) pension schemes offered under auto-enrolment will begin to offer funds with an element of autonomy for savers as part of their range of fund options.

Some participants in our roundtable expressed caution, pointing out that diversification and risk pooling were a key part of the benefit of pension funds, and that individuals left to their own devices might put too many eggs in one basket or make unwise decisions. They also stressed that it was important not to open the door to "charlatans hoovering up people's savings" - echoing calls from new entrants themselves for this emerging sector to be properly regulated. Others argued that the process of building a balanced and diversified portfolio is not as complex or inaccessible as is commonly portrayed, and that it would not be impossible to build a culture where people gained the confidence to do this with at least a small part of their investments. Either way, self-directed investments seem likely to remain a relatively small part of the market for the foreseeable future.

CASE STUDIES - SELF-DIRECTED INVESTMENTS

Ethex[119] is a not-for-profit ethical investment intermediary whose declared aims are to make it easier for individuals to invest directly in businesses with a positive environmental or social impact, to help social businesses to access capital, and to create a more liquid market for ethical shares. Its platform includes both funds and individual companies, all of which are listed along with 'triple bottom line' indicators showing how the business performs both financially and on environmental, social and governance (ESG) criteria. The minimum investment is £10; online resources take new investors through the basics of the different types of investment and what they should consider when choosing between them. Although in early stages of development and with a limited number of businesses listed, this model could theoretically be used to enable savers to build up a diversified portfolio of assets in which to invest a proportion of their long-term savings. It could also be applied to investments beyond the social enterprise sector.

Abundance Generation[120] is an online crowd-funding platform which allows people to invest directly in renewable energy projects, both by funding new projects and by trading existing assets with other users. The minimum investment is £5; investments can also be made via a Self-Invested Personal Pension (SIPP). Again, the technology behind this platform is not particularly complex; what is distinctive is the ethos of connecting savers directly to projects which they believe are worthwhile, a model few if any mainstream providers have shown interest in.

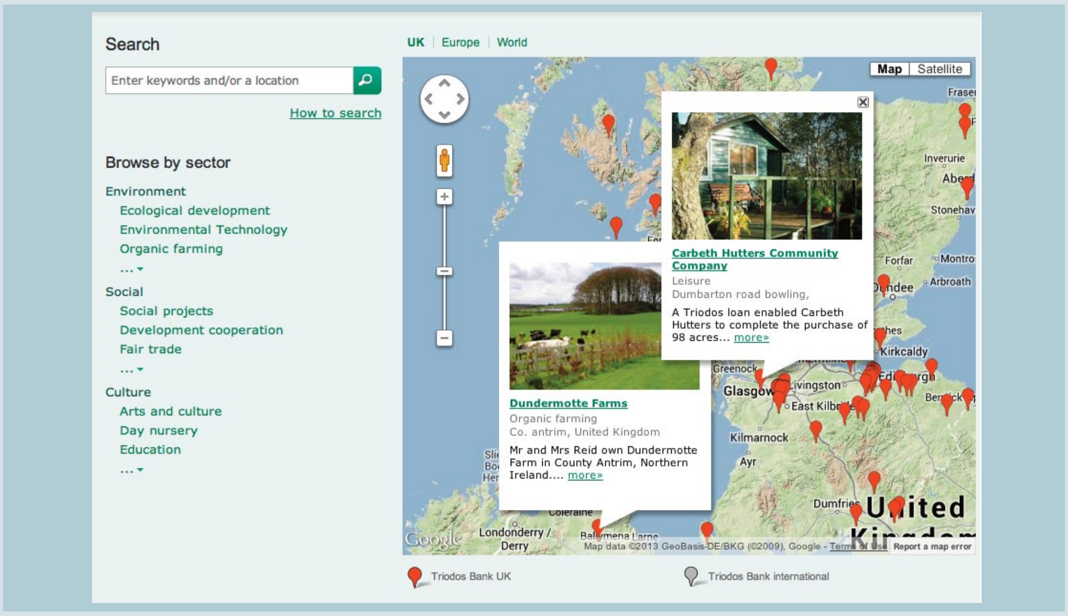
Making it real: lessons for mainstream investors

If doing away with traditional intermediaries is unlikely to become the norm, the next question is whether competition from alternative providers could help to incentivise innovation in the mainstream. What lessons can institutional investors draw from these new entrants? One key lesson lies in the way they use technology to provide people with accessible and meaningful information about their investments. Even in mainstream investment products where savers are not directly deciding where their money goes, the internet still has the potential to give them much more visibility about the decisions being made on their behalf.

Moreover, the growth of this subculture demonstrates that investment need not be an alienating concept. Showing the tangible results of people's investments can be a powerful tool for engaging and enthusing them about saving - particularly where people can see that their money is making a positive contribution to the economy, for example by investing in job-creating businesses or helping to build the infrastructure for an environmentally sustainable future. There are lessons here not just from new entrants in the investment sphere, but also from alternative providers in other aspects of financial services, such as Triodos Bank (see box).

CASE STUDY: TRIODOS BANK

Triodos Bank has made a selling point of its innovative approach to connecting people with their savings. Account holders can browse interactive online maps and articles about the businesses and projects their money is being lent to, and even visit them in person.[121] (By contrast, mainstream banks are only beginning to disclose postcode-level information about where they lend, pushed by the threat of regulation.[122]) Annual meetings combine the opportunity to ask questions of the bank with a chance for borrowers and lenders to meet, as well as outside speakers on key debates and developments in sustainable finance. Such innovation can make the abstract and nebulous world of finance concrete and meaningful - yet it is almost entirely absent in the pensions and investment industry.



Although the providers discussed in this chapter all focus on enabling people to put their money into 'ethical' projects and businesses, the message for mainstream investors is not just about where money goes but how this is communicated. Perhaps because ethical investors are by definition concerned to know where their money goes, ethical banks and investment providers have often led the innovative use of technology to give people a sense of connection with the real economic activity they are financing. As discussed in chapter 2, there is no reason why mainstream providers cannot do the same - both by being more transparent about where money goes, and by changing the way they talk about investment to focus less on financial abstractions and more on the 'real world'. Showing savers how the scheme is behaving as an owner - particularly of companies which are household names - offers one tangible way of doing this. By learning from alternative providers, institutional investors can cultivate a sense of ownership, making people feel that they have not just a savings pot sitting under some hypothetical mattress, but a stake in the economy.

> *Even in mainstream investment products where savers are not directly deciding where their money goes, the internet still has the potential to give them much more visibility about the decisions being made on their behalf.*

> *The technology to transform the relationship between savers and their investments is already available. What is lacking is the commercial pressure and the culture of participation which would catalyse such transformation*

Conclusion

Although the theme of this chapter is new technology, none of the possibilities we have explored involve particularly complex technological developments. The technology to transform the relationship between savers and their investments is already available. What is lacking is the commercial pressure and the culture of participation which would catalyse such transformation. It is to be hoped that the growing popularity of alternative ways of investing will help to provide this catalyst. Civil society must also play its part by educating and enthusing savers about the power of their money. Meanwhile, those within the mainstream who take a leap of faith and begin to use technology in a genuinely innovative way are likely to reap benefits in terms of reputation and consumer trust.

Conclusion and Recommendations

In the debate about responsible capitalism, far too little attention has been paid to the question of who the real capitalists are. In this report, we have argued that making capital markets more answerable to the individuals whose money they invest offers a potentially powerful lever both for rebuilding trust in the City and for promoting more responsible and long-termist corporate behaviour. We envision a world where savers feel that they have not just a savings pot but a stake in the economy - and where the current focus on promoting the exercise of 'voice' by shareholders in listed companies is matched by an equal focus on voice for the underlying savers.

Such a world must be built over time: by institutional investors with a genuine commitment to transparency and accountability; by savers demanding more of those who look after their money; and by civil society and consumer groups helping savers to appreciate the power that money holds. Policymakers can only set a floor, guaranteeing savers' rights to information and participation. However, setting that floor is a vital first step. At present, an outdated legal framework means that savers have limited rights, creating a vicious circle of disengagement. A concerted effort to grant savers the right to hold institutional investors to account could help to transform this vicious circle into a virtuous circle, laying the foundations for a more inclusive and accountable economy. We hope that the recommendations in this report will catalyse further debate about how this could be achieved.

> *We envision a world where the current focus on promoting the exercise of 'voice' by shareholders in listed companies is matched by an equal focus on voice for the underlying savers.*

Summary of Recommendations

Laying the foundations

- Given the tendency to apply outdated ideas from private trust law to pensions, explicit legal clarification is desirable: (a) to confirm that fiduciaries can take beneficiaries' views into account when making investment decisions, and (b) to give beneficiaries the right to an account of decisions made on their behalf.

- Government, employers and the investment industry should take active steps to educate current and future pension savers about where their money goes.

Transparency

- Pension schemes should be required to disclose a list of their major holdings on at least an annual basis. Savers should have the right to receive more detailed information on holdings on request.

- The SIP regulations should be reviewed to ensure that schemes disclose their policy on managing ESG risks and their approach to stewardship. This should include a requirement to disclose whether they comply with the UK Stewardship Code, and if they do not, to explain why.

- The existing requirements for occupational pension schemes to produce an annual investment report should be amended to more closely mirror companies' narrative reports, focussing on (a) how schemes have implemented their investment policy during the year, and (b) how they are managing long-term risks to savers' investments. This requirement should also be extended to personal pensions.

- The government should exercise its reserve powers to make voting disclosure mandatory for institutional investors.

Participation

- Pension savers should have the right to be consulted on the development of investment policies, and/or to trigger a review of their scheme's investment policy if a sufficient number of them request it.

- Savers should be provided with contact details for any queries about their investments, and should have the right to receive a response to reasonable requests for information (including the reasons for decisions).

- Like listed companies, pension schemes should be required to hold annual meetings giving savers an opportunity to scrutinise the decisions of the board.

- Contract-based pension schemes should be required to include some form of member representation in their governance, in the same way that occupational pension schemes are required to have member-nominated trustees.

- Government should explore ways of promoting institutional structures which 'build in' accountability to members.

Harnessing new technology

- Government should explore ways to make the shareholder voting chain more responsive to the wishes of individual savers, and should encourage institutional investors to experiment with innovative ways of achieving this.

Appendix

List of roundtable participants

Christine Berry	ShareAction
Jocelyn Brown	Financial Reporting Council
Alastair Cowie	Department for Business, Innovation & Skills
Bruce Davis	Abundance Generation
Mark Goyder	Tomorrow's Company
Chris Hewett	Finance Innovation Lab
Anna Hirschfield	Department for Work and Pensions
Catherine Howarth	ShareAction
Howard Jacobs	Former Director, USS
Maighread McCloskey	Labour Party
Paul Moxey	Association of Chartered Certified Accountants
David Pitt-Watson	London Business School
Tom Powdrill	Pensions Investment Research Consultants (PIRC)
Paul Todd	National Employment Savings Trust (NEST)
Janet Williamson	TUC

Organisational affiliations are given for information only. All participants attended in a personal capacity and the event was held under Chatham House Rules.

The opinions expressed in this paper are those of ShareAction and are not necessarily endorsed by roundtable participants.

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