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Dear PADA Investment Consultation team

**Response of UKSIF – the sustainable investment and finance association – to the discussion paper on designing an investment approach**

Thank you for the opportunity to comment on the discussion paper “Building personal accounts: designing an investment approach”.

This submission addresses Chapters 7 and 8 of the paper. It has been informed by discussions with the UKSIF Sustainable Pensions Advisory Board<sup>1</sup> and with some of the leading UK asset owners and asset managers within UKSIF's membership. It has also been informed by our participation in your Responsible Investment seminar in January 2009 and our meetings with PADA and DWP officials since 2006.

**Introduction and Summary**

We warmly welcome PADA's interest in the role of responsible investment in protecting and enhancing long-term returns to the benefit of scheme members. We believe that long-term responsible investment is essential to a successful personal accounts investment strategy.

We propose that the personal accounts scheme:

- signs and implements the PRI
- collaborates with and learns from other pension schemes for cost-effectiveness
- applies responsible investment across all fund choices and asset classes
- builds responsible investment into the selection and assessment of fund managers
- considers a gradual approach to implementing responsible investment as a reasonable way to deliver cost-effectiveness and benefit from future economies of scale
- explicitly recognises that responsible investment helps the trustee corporation to fulfill its fiduciary duty and ownership imperative.

A responsible investment approach has become the norm amongst leading public pension funds across Europe and is increasingly being adopted globally<sup>2</sup>. Amongst these major pension funds there is an emerging consensus that responsible investment implies recognition that, firstly, environmental, social and governance (ESG) issues can affect the performance of investment portfolios and secondly, with ownership rights come ownership responsibilities.

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<sup>1</sup> See Appendix I

<sup>2</sup> For example, the PRI now has 182 asset owner signatories.

We welcome also the inclusion of ethical and religious-compliant funds in Chapter 8 of the discussion paper. It is essential that the personal accounts scheme offers sufficient high quality and low cost ethical and religious-complaint funds to meet public demand.

Three key principles should underpin the personal accounts scheme's adoption of responsible investment. These are:

- responsible investment should be applied across the personal accounts scheme, including but not limited to the default fund
- consumer choice is critical for building confidence in the scheme. High quality and comparable cost ethical and religious-compliant funds are central to this
- over time, the personal accounts scheme will become a very large "universal investor" asset owner with influence on other UK asset owners, the investment community and the companies in which it invests

## **Response to particular questions**

### **7.1 How can the personal accounts scheme engage in responsible investment in a cost-effective way?**

Collaboration and learning from other pension schemes and institutional investors as a peer network is a cost-effective way of benefiting from responsible investment. The experience of the Environment Agency Pension Fund is instructive. In his introduction to its recent report, Howard Pearce, Head of Pension Fund Management explained that "...through research and analysis of the investment manager market, and by working with other like minded pension funds and via our involvement in collaborative initiatives...we have made progress".<sup>3</sup> For a number of leading pension funds the UN-backed Principles for Responsible Investment (PRI) acts as a focal point. This was elaborated upon by Donald MacDonald of the BT Pension Scheme and Chair of PRI in his remarks at your Responsible Investment seminar.

The experience of other pension schemes indicates that for cost-effective responsible investment, it is essential that it be built into the selection and assessment of fund managers. Leading consultants have developed expertise in this area. By using this, the personal accounts scheme can identify and measure fund managers' capabilities.

The costs associated with responsible investment should not be looked at in isolation but in the context of long-term cost reduction and overall net returns to the portfolio. This point is discussed in more detail in our response to the earlier consultation on Charging Structure.

A gradual approach to implementing responsible investment is a reasonable way to deliver cost-effectiveness. The personal accounts scheme may wish to consider scaling up the resources it allocates to responsible investment as its assets grow and it expects to benefit from economies of scale. However for a gradual approach to be most effective, responsible investment objectives need to be determined at the outset.

### **7.2 Should responsible investment be a matter for the default fund alone, or for all fund choices, as far as it is practical and relevant?**

The personal accounts scheme's starting point should be that responsible investment ought to be practiced across the entire scheme. In principle, it should apply to all fund choices. This is because the case for responsible investment is based on financial risk and opportunity and the scheme's imperative as an asset owner.

As part of this, responsible investment should be used for all asset classes. UKSIF's 2009 survey of the pension schemes of UK corporate responsibility leaders found that where private

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<sup>3</sup> Taken from Foreword to the Environment Agency Active Pension Fund's "Responsible Investment Review"  
<http://www.environment-agency.gov.uk/aboutus/organisation/35603.aspx>

equity, bonds, property, hedge funds and alternative investments were held by pension funds with a responsible investment policy, they were covered by the policy in about half of cases<sup>4</sup>.

### **7.3 How should the trustee corporation interpret its fiduciary duty in relation to responsible investment while maintaining a commitment to low charges?**

Fiduciary duty obliges pension schemes to act “in the best interests of members and beneficiaries”. An effective responsible investment approach can help the trustee corporation fulfil its duty both in relation to maximising returns for scheme members (as addressed above) and in exercising its ownership responsibilities. As the discussion paper sets out, one key argument for this is universal ownership (sections 7.12 to 7.14).

The current financial crisis has raised questions of whether asset owners historically have devoted sufficient attention and resources to ownership issues<sup>5</sup>. The recent Walker Review proposal for a “stewardship obligation” for fund managers suggests that the trustee corporation as a large asset owner should consider itself to have a duty of stewardship<sup>6</sup>.

The 2001 Myners Review and subsequent Investment Governance Group, the Institutional Shareholders’ Committee and the NAPF all recognise that owners have a duty to hold directors accountable for governance and corporate responsibility, and that exercising this duty can protect financial value. The Pensions Regulator’s 2009 draft revised guidance on the scope of the Trustee Knowledge and Understanding (TKU) requirements for defined contribution schemes includes a section on “the importance of responsible ownership of assets”<sup>7</sup>.

As noted in Box 7.1 of the discussion paper, fiduciary duties evolve over time. We would encourage the trustee corporation to consider the proposals and recommendations of the “Fiduciary II” report published in 2009 by the UNEP FI Asset Management Working Group<sup>8</sup>.

### **7.4 If responsible investment is pursued, will the members be best served by building in-house capability or outsourcing?**

There is no one model for pursuing responsible investment. As with other aspects of the investment process, the most effective, and low cost, way of achieving this will be through a mix of in-house capability and outsourcing. Pension schemes have developed and applied a number of different models<sup>9</sup>.

For any approach to be effective there needs to be sufficient knowledge and understanding of responsible investment amongst the trustee corporation and its staff. Leading UK pension funds have developed their knowledge and understanding through increased trustee training, appointing in-house responsible investment managers and use of consultants.

### **Principles for Responsible Investment (Sections 7.32 to 7.35)**

UKSIF strongly recommends that the personal accounts scheme signs the PRI. The benefits of this were set out by James Gifford in his presentation to your Responsible Investment seminar.

<sup>4</sup> “Responsible Business: Sustainable Pension” 2009

[http://www.uksif.org/projects/sustainable\\_pensions/Corporate\\_Pension\\_2009](http://www.uksif.org/projects/sustainable_pensions/Corporate_Pension_2009)

<sup>5</sup> For example Lord Myners and Hector Sans’s speeches to the 2009 NAPF Investment Conference

<sup>6</sup> See Chapter Five of “A review of corporate governance in UK banks and other financial industry entities”

[http://www.hm-treasury.gov.uk/walker\\_review\\_information.htm](http://www.hm-treasury.gov.uk/walker_review_information.htm)

<sup>7</sup> The TKU draft scope guidance documents, including the “Draft revised scope guidance: DC Schemes”, are currently laid before Parliament <http://www.thepensionsregulator.gov.uk/pdf/TKUscopeforDCOnly2009.pdf>

<sup>8</sup> “Fiduciary responsibility – Legal and practical aspects of integrating environmental, social and governance issues into institutional investment” <http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf>

<sup>9</sup> The 2007 report by UKSIF and UNEPFI “Responsible Investment in Focus: How leading public pension funds are meeting the challenge” provides detailed examples of some of the most advanced approaches being adopted by public pension funds [http://www.uksif.org/projects/sustainable\\_pensions/publications](http://www.uksif.org/projects/sustainable_pensions/publications)

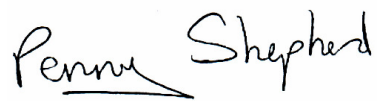
The majority of leading European default and public pension schemes are signatories to the PRI. In its 2009 guidance, NAPF described the PRI as a “key element” of “a framework to support the integration of corporate responsibility into the investment process”<sup>10</sup>.

### **8.1 To what extent should the trustee corporation offer fund choice, and what should these choices be?**

We seek to address this only in respect of ethical and religious-compliant funds.

The personal accounts scheme should offer sufficient high quality and low cost ethical and religious compliant funds to meet public demand and serve the increasing interest in ethical and faith-consistent investment (as noted in Box 8.1).

With best wishes



**Penny Shepherd MBE**  
Chief Executive

### **Appendix I – UKSIF Sustainable Pensions Advisory Board**

The UKSIF Sustainable Pensions Project assists UK occupational pension schemes to adopt more responsible investment strategies with the goal of protecting and enhancing long-term shareholder value and financial returns for scheme beneficiaries. It is overseen by an independent Advisory Board. *All members serve in a personal capacity:*

Michael Deakin, Michael Deakin Consultancy Ltd (Chair)  
Sally Bridgeland, BP Pension Trustees Limited  
Tim Currell, Hewitt Associates  
Duncan Exley, FairPensions  
Jane Goodland, Watson Wyatt  
Peter Montagnon, ABI  
Will Oulton, FTSE Group  
Andrew Parker, BT Pension Fund  
David Paterson, NAPF  
Mike Taylor, London Pensions Fund Authority

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<sup>10</sup> “NAPF Responsible Investment Guidance” March 2009 <http://www.napf.co.uk/Policy/Governance.cfm>