

Holding pension funds to account

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As [the Guardian has noted this morning](#):

The UK's fund management industry is "ripe for investigation" because of "an alarming lack of transparency that surrounds [its] pay and practices", the influential Institute of Directors said on Sunday.

Simon Walker, director general of the IoD, said "uninterested" financial regulators should wake up "to avoid another scandal of epic proportions."

I agree, entirely. [This is a blog I wrote](#) on pension fund accounting (a wholly related issue) in January 2014, but as I noted, the thinking had developed over number of years before that time:

I wrote most of what follows on the need for massive accounting reform in the pensions industry to make this sector accountable to those who provide it with its funding and who are dependent upon it in 2009. I updated it a bit in 2012, and nothing then came of the idea; I can't now recall why. It was some thinking for a research project that has not happened, and is not now on my agenda and which I have no time to pursue.

However, it remains highly relevant, not least in the [light of the comment by Polly Toynbee in the Guardian today](#) on the government's failure to cap pension costs which will leave the vast majority of people in this country open to continuing abuse from the pensions industry.

So I now offer the idea — for what I called 'pensionholder' reform for others to pick up if they will.

Background

I got a statement from my pension fund recently. It was a depressing read. I will be impecunious in my old age: the fund have not managed to make investment returns since time immemorial; the amount I have paid in over the years seems hardly to have grown despite the tax relief the fund supposedly

enjoys, and worst of all I am offered no explanation of any sort at all for this state of affairs.

It is the last fact that troubles me most. I entrust a pension fund with my money and, to be candid, I get nothing in return. If I invested my money in a company I would expect to get a full set of audited accounts from them each year. Implicit in that relationship with a company in which I invest is the understanding that the directors are acting as steward for my funds and must account to me, in some detail, about what they have done with it.

Company accounting

So a company tells me about who runs the show — and what they are paid, in considerable detail. They tell me what they are seeking to achieve, and even if I know a lot of that is spin I also know that there is some credibility underpinning it in most cases.

They tell me how they have traded, what they trade, in some cases where they have trade (although I usually want to know more about both what and where they trade). I know what costs they incur, how many people they employ and what they pay them, at least on average. The profit or loss is declared and I know if tax is paid. I also get a balance sheet to show me how the funds are invested on my behalf — and even if they have no idea who I am and probably care less the point is I get all this data. And I appreciate it.

Pension accounting

But if I give my money to the tax preferred pension fund that are meant to manage it for me, with state endowed tax preference built into the relationship I get none of this. I am told the value of my fund and if it has gone up or down, and how much of that is due to me paying cash in. I am told what they will pay me back on the fund, which ludicrously is always less than it is supposedly worth — by a margin of well over 20% on the current statement, making a mockery of any value given. And then I am told that if the fund were to grow using wildly optimistic forecasts which seem to bear no relationship with past performance I might bet a tiny pension in many years time that has the sole effect of alienating me from the entire process.

The pension reporting conundrum

Why is this? Why is it that when a company is required to account to each and every shareholder — even if they have a minute holding — the data I get from a pension fund on which my future well being might depend is so pitifully small? And why do I know nothing at all about what this fund does to make the return I enjoy?

The scale of the issue

We all know that stock markets have failed badly of late. We all know that there is demand that management be held to account for what they do. But the reality is that I, like most in this country, engage with the stockmarket (when I have to) through the offices of a third party — a pension fund — run in turn by a company that is itself quoted on the stock market — and they don't even send me their own accounts which I'd get as a shareholder. I'm far from being alone in this situation. [Up to £70 billion a year has been paid into UK pension funds](#). Almost half of that came from voluntary contributions. Total value of current UK defined contribution pension funds to which these contributions are made may be [£450 billion \(August 2009 data\)](#) . These are the funds I am worried about: the sort where the investor takes the risk if things go wrong and so needs the maximum information on what is happening in their fund. Despite this even people [like PIRC \(Pensions Investment Research Consultancy\)](#) place little or no emphasis on reporting to shareholders when they discuss the crisis of governance in the City that the current financial climate has exposed.

Moral hazard

I am not happy about that. I know that unless there is accountability there is moral hazard: that is the phenomena where a party (in this case the pension fund) is insulated from risk and so behaves differently from the way it would behave if it were fully exposed to that risk. The risk would be the challenge to pension fund management that would arise if we knew just what they were doing for us.

The information we need

So what information do we need as pension fund holders to ensure that the funds in which we invest are truly accountable to us for what they do, always remembering that if we held them to account for that this could in turn create the pressure to hold the City to account for what it does, so creating pensionholder capitalism?

I suggest the following would do for starters, to be sent to every pensionholder every year as if they held shares in a company for whom such accountability is, of course normal:

1: Who runs the fund

1.1: The name of the company

1.2: A summary of their accounts

1.3: Full details of where and how their full accounts can be obtained

1.4: The name of the fund in which the prospective pensioner has invested

1.5: Where the constitution of that fund can be obtained from, and how

1.6: The names of the individual pension fund managers responsible for the fund and for each such manager:

1.6.1: Their age

1.6.2: Summary CV

1.6.3: Qualifications to undertake the task entrusted to them

1.6.4: Remuneration, split between basic pay and bonuses

1.6.5: Any other appointments they have

1.6.6: Any conflicts of interest they might have e.g. personal shareholdings

1.7: The method of changing the fund managers available to the prospective pensioner

2: What the fund has done

2.1: What its income was in a year, split between:

2.1.1: Dividends

2.1.2: Interest

2.1.3: Rents

2.1.4: Hedge funds

2.1.5: Private Equity

2.1.6: Profits and losses (each stated separately to come to a net disclosed figure) from trading investments split between

2.1.6.1: Equity shares

2.1.6.2: Corporate bonds

2.1.6.3: Government bonds

2.1.6.4: Property

2.1.6.5: Cash related activity e.g. foreign exchange trading

2.1.7: Income from other sources

2.1.7.1: Stock lending

2.1.7.2: Fees

2.2: Volume of trading

2.2.1: Gross purchases and sales of each of the following netted to produce a net movement

2.2.1.1: Equity shares

2.2.1.2: Corporate bonds

2.2.1.3: Government bonds

2.2.1.4: Property

2.2.1.5: Hedge Funds

2.2.1.6: Private Equity

2.2.1.7: Cash held in other currencies

2.3: Costs of trading

2.3.1: Split by category, as noted above

2.4: Movements in value of assets in the year, not yet realised

2.4.1: Increases and decreases in value for each of the following, each then netted to a total

2.4.1.1: Equity shares

2.4.1.2: Corporate bonds

2.4.1.3: Government bonds

2.4.1.4: Property

2.4.1.5: Hedge Funds

2.4.1.6: Private Equity

2.4.1.7: Cash held in other currencies

2.5: Administration and other costs

2.5.1: Salaries

2.5.2: Research

2.5.3: Overhead costs

2.5.4: Management fees to parent institution

2.5.4.1: NB if the previous three categories are included in a management fee an indicative split of the management fee into these categories should be given

2.5.5: Audit fees

2.5.6: Regulatory fees

2.5.7: Other costs

2.6: Surplus for the year

2.6.1: The surplus or deficit for the year allocated by sub fund if appropriate

3: What the fund invests in

3.1: A balance sheet for the fund

3.1.1: Investments

3.1.1.1: See separate notes below

3.1.2: Current assets

3.1.2.1: Split in the format required by Company Accounts

3.1.3: Current liabilities

3.1.3.1: Split in the format required by Company Accounts

3.1.4: Member funds

3.1.4.1: Opening funds plus contributions less the result for the year equals closing member funds

3.2: Investments

3.2.1: Detailed notes required by asset category showing value brought forward, additions, disposals and movements in asset value — to reconcile with notes in the statement of what the funds has done — leaving closing cost

3.2.2: Equity shares

3.2.3: Corporate bonds

3.2.4: Government bonds

3.2.5: Property

3.2.6: Hedge Funds

3.2.7: Private Equity

3.2.8: Other

3.3: Investment analysis

3.3.1: List the top 100 investments by value at the start and end of the year and note the following for each

3.3.2: Name

3.3.3: Type of asset by category already noted

3.3.4: Proportion of the fund invested in the asset and proportion of the asset held (e.g. what percentage of the company invested in is owned)

3.3.5: How the asset invested in generates its income .e.g. what use is made of a let property, what trade a company pursues

3.3.6: Whether the investment is considered ethical, referencing an accepted standard

3.3.7: Whether the investment is in a low tax jurisdiction (headline corporate tax rate of less than 20%)

3.3.8: Value at the start of the year

3.3.9: All purchases

3.3.10: All sales

3.3.11: Profit or loss

3.3.12: Value at end of year

3.3.13: Total income received

3.3.14: Income of highest paid director in company invested in

3.3.15: Whether the fund voted against any resolutions put by the company in the year and if so what on and why

4: Other information

4.1: Future investment policy

4.2: Green policy

4.3: Ethical policy

What this information would let us do

There are numerous good reasons for providing this information. First and foremost being accountable is a key component in good governance. It is extraordinary that we have a system of pension fund management that outside people's houses represents one of the biggest repositories of wealth in the UK and yet no one, the Turner report included, thinks it necessary to require proper accountability of the funds in which people deposit their savings and about which, in consequence, they know almost nothing.

Second, when something is observed it changes. If pension funds can be better monitored their performance will improve. This is vital for our well being.

Third, this data empowers pension fund holders to ask questions of their fund. At present this is almost impossible to do.

Fourth, pension fund holders will now know they have direct association with major companies of whom they might never have heard but whose performance is vital to their own future. Nothing will drive improved performance and governance in the City like being accountable to a mass of people will.

Fifth, people should be allowed to vote the shares their pension fund holds if they so wish and attend at the annual general meetings of the funds in which their fund is invested and speak as if members if they so wish. This will break the stranglehold that 'investors' are considered to be pension fund managers, most of whom come from the same background as those whom they are meant to be holding to account but which they have completely

failed to do.

Sixth, transparency will improve choice and so performance in the market. Alternatively, and as importantly, it will bring pressure to bear to reduce cost and churning of investments if both have to be reported, as the above disclosure requirements implicitly require. These are at present major areas of suspected abuse of pension funds by fund managers.

Seventh, such accountability may improve the rate of pension saving.

Eighth, this accountability will require pension funds to account for the enormous tax benefits they receive.

Ninth, the risk of pension failure should be reduced.

And tenth, people might have a better sense of well being if they can better understand what their pension fund is doing for them.

What will it cost?

Such a proposal is bound to result in a clamour of protest from the City and all pension fund managers. There is one obvious response to that, which is that all markets work best when the highest quality information is available to all participants and why should the enormous pension sector be any different?

Cost is, however an issue, but one that is almost irrelevant. Firstly, all pension funds are audited already. Second, this data (with tiny exceptions — such as that on ethical standards, which is industry generic and therefore easy and cheap to procure) has to be produced already is a pension fund is to prepare proper accounts. Therefore, and third, the only significant additional cost would be printing which could be avoided by providing the report in default form on the internet with hard copy being sent only to those who specifically request it.

And cost may not, in any event, be an issue. It may well be that the pressure of exposure will result in considerably more cost being saved than this measure will cost: the outcome of transparency is almost always enhanced performance and that is what should be expected here. In other words, cost is not an issue.

Why now?

Now is the time for reform. It is the government's intention that more people should, as a result of the Turner reforms to pensions, be required to invest in stock market based pension funds. The obligation may or may not make

sense but what is without doubt true is that compulsion without accountability is unacceptable. This therefore is the time to create accountability within out pension funds and in turn a whole new pensionholder capitalism where those who manage pension funds and the companies they are in turn investing in are held to account by those on whose behalf they act — the future pensioners of the UK. Then we move towards a world of real openness, transparency and accountability which is essential if we are to bring an end to the excess, waste and unaccountability of the City, our financial institutions and British business.