

# Implementing a National Pensions Savings Scheme

## Paper by IMA

### OVERVIEW OF IMA PROPOSALS

1. This paper sets out the model which the IMA<sup>1</sup> considers the most likely to achieve the Government's objectives if it proceeded with the National Pensions Savings Scheme (NPSS). It has common features with that of the Pensions Commission's own proposal, in particular the advantages of central collection and administration. However, it identifies some gaps, for example independent governance, which it will be essential to fill if the scheme is to gain the trust of potential participants.

### The Challenges

2. Setting up an NPSS carries significant risks for Government if it is not designed correctly. If it is to be effective, then it must meet three challenges:
  - a) It must get sufficient take up from those not currently covered by pension saving arrangements. A high level of take up is essential to ensure that charges do not act as an undue drag on investment returns. Without adequate take up, the fixed costs of the scheme would be spread over too small a flow of savings producing annual charges that are too high for the Government's objectives.
  - b) It needs to be structured such that the flow of savings is a genuine addition to pension savings and not a substitution away from existing pension and savings arrangements.
  - c) It must demonstrably deliver access to the highest standards of professionalism in investment. Particularly so given that the scheme's assets are likely to come to represent the single most substantial financial asset owned by several million people of otherwise modest means.
3. A pre-requisite is that savers need to be confident that the specific arrangements will operate fairly in their interest and that they will be in place for the long term.

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<sup>1</sup> IMA members include independent investment managers, the investment arms of banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management in the United Kingdom of over £2 trillion of funds, including authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

## NPSS Governance Structure

4. In order to fulfil these considerations, NPSS has to be set up in a way which operates in the interests of members and minimises political risk. This requires that:
  - The scheme should be independent of government and accountable to Parliament, with functions akin to those of a board of trustees in an occupational defined contribution scheme.
  - The scheme would have an overriding duty of care to its members.
5. This duty of care has two quite distinct facets, which probably require separate governance arrangements:
  - The first is a **duty of safe custody of members' contributions, efficient administration of their accounts and effective communication/education regarding investment options**. It would be reasonable to expect some stakeholder representation in these aspects of the running of the scheme.
  - Centralised administration of the investor accounts would make use of the wide range of systems already available in the private sector. Individuals would receive annual statements of their accounts describing how their assets are invested and what they are worth.
  - The second duty would be **to ensure that contributions are invested in the best interests of members**. The scheme would be given responsibility to oversee all aspects of investment – most importantly, the range of investment choices provided to investors and the appointment of fund managers. These aspects need to be entrusted to a group of individuals skilled and experienced in investment matters.
  - Because many people are reluctant to take investment decisions, and indeed may not feel competent to make them, a default investment choice would be put in place, to which it is likely most members would belong. Responsibility for defining and supervising the default arrangement would lie with the NPSS scheme.
6. The scheme would be fully transparent in respect of both of these main duties, reporting annually to Parliament on its objectives, how it is seeking to meet them, and performance. Appendix I provides an illustration of lines of accountability within the scheme.

## Key Advantages

7. This structure brings with it several key advantages:
  - **Insulation from political pressures.** The independent governance structure ensures separation of the scheme and the members' assets from the political pressures to which governments are inevitably subject. Without clear lines of accountability that do not go through Ministers, compulsion, even in the "soft" form of auto-enrolment, introduces potential moral hazard and political risk for government. Independent governance is to the benefit of both government and

scheme members. This model achieves that more effectively than any other we have seen.

- **Diversification and best practice.** Providing the possibility of diversified asset management – across managers, asset classes and investment strategies -- will help to ensure access to the highest standards of professionalism in the institutional investment market. The performance of the scheme's investments will inevitably be subject to close scrutiny, and it will be important to be able to demonstrate that rigorous analysis and monitoring was brought to bear on decisions being taken on behalf of scheme members.
- **Best value.** By placing competition for institutional investment management at its core, it will deliver the best value for money to investors. As experience of the occupational pensions market has shown, competition between fund managers, with trustees fulfilling the "intelligent customer" role on behalf of scheme members, produces best outcomes, including low charges without the intervention of price caps or regulators. In addition, a centralised administration, which minimises duplication of costs, and an absence of brand marketing means that this structure is likely to result in lower costs than the alternatives.

### **Meeting Government Requirements**

8. In terms of meeting specific requirements, the Secretary of State has laid out five tests for the long-term package of pensions measures now under consideration:

- Does it promote personal responsibility?
- Is it fair?
- Is it affordable?
- Is it simple?
- Is it sustainable?

9. The model described in this paper addresses these criteria in the following ways:

- Personal responsibility. Setting up a system based on individual accounts, collectively invested and with access therefore to professional institutional asset management with independent and accountable governance, will help to build sustainable credibility for the NPSS. This in turn should help to persuade individuals to persist with NPSS or to begin to participate if they have previously been doubtful. It may also help to reinforce a wider culture of personal long-term savings.
- Fairness. Universality of access for NPSS participants to the best institutional investment management services, overseen by an independent Board, should assure fairness. In particular, it would avoid the kind of pensions 'lottery' with respect to default funds that currently exists within the stakeholder market, and would likely be perpetuated in any retail-based NPSS platform.

- Affordability. IMA assumes that the NPSS would only work if it was affordable. As noted in Paragraph 7 and discussed later in this paper, it believes that a scheme could be designed in such a way as to be so.
- Simplicity. Simplicity is provided by the fact that there is a single structure – the NPSS – which provides a long-term savings product via a centralised collection and administration system.
- Sustainability. Sustainability should be ensured through a combination of strong governance, public accountability and independence.

## DETAILED PROPOSALS

### PART I. Governance

10. The right governance structure is critical. It must achieve the following:
  - Investors must have legal ownership of the assets of the scheme; they must not be capable of being confiscated by a future Government.
  - They must be invested so as to achieve the best return, as judged by the best available analysis, or in accordance with the wishes of the individual member. Investment must not be driven by political pressures.
11. For this to be the case, future Governments need to be confident that they will not be held responsible for investment returns that, for whatever reason, disappoint. However, somebody needs to be accountable for the investment returns which are achieved.
12. It is tempting to argue that, so long as individuals are responsible for making the investment choices, Government cannot be held responsible for the outcome. But international experience suggests that most individuals do not choose, and prefer a default arrangement instead. Given that they are being auto-enrolled, scheme members will expect public accountability for the design, management and performance of the default scheme.
13. Nor is it sustainable to allocate non-choosers at random to a selection of providers, as in the case of the Child Trust Fund. The difference is that the CTF is a benefit provided by Government; in this case money would be being taken directly from members, sanctioned by legislation, and invested on their behalf. Performance will inevitably vary, and those allocated to a lower performing fund will argue that they were let down and demand compensation. Any future Government will not be able to assume that handing over the investment function to private sector providers will absolve it of any responsibility. In 1988, the Civil Service Pension Scheme appointed two providers of AVC arrangements, one of whom was Equitable Life. It is inconceivable that in comparable circumstances in the future the Government would simply be able to stand by if a default provider to the NPSS ran into trouble.
14. The structure needs to have a clear line of ownership from an individual to the assets in order to avoid any issues, for example insolvency of a provider.
15. In seeking the right structure to achieve the goals, trustee models from occupational pension schemes offer a useful analogy. Boards of Trustees and their advisers bring a combination of expertise, fund manager scrutiny, transparency and accountability that IMA believes is a pointer to some essential requirements for NPSS.
16. Such a model can be structured in many different ways: from employer or multi-employer to regional or national. An argument for the NPSS to have a single 'national' structure, as opposed, for example, to industry, regional or multi-employer schemes, is the universality and simplicity of such an arrangement. With a national trustee structure, it is possible to avoid a lottery of pension outcomes, whereby

NPSS participants feel that they may have lost out from being in schemes that see substantial variations in fund strategy and performance. A further advantage is that an account with a national scheme would be fully portable as individuals changed job, industry or region.

### **The duty of care and implications for structure**

17. In order to provide the necessary accountability, legislation will need to make NPSS independent from Government, but accountable to Parliament. It would have a statutory duty of care to members that would override all other considerations. This needs to cover two distinct roles:
- Custody and safekeeping of contributions. This would include, *inter alia*, contracting with the collection agency, setting standards for collection, verification and payment; contracting with the administration and transfer agency; information and education for members; and arranging custody of assets.
  - Arranging Investment. The second duty would be different and more specialist. It would include deciding on the range of choice available to investors; the strategy for investment of the default fund; and appointment and monitoring of fund managers.
18. The first duty would cover the overall management of the NPSS. It is one in which stakeholders might be expected to have some say. But the second is a specialist duty which should be confined to those with the requisite skills and experience. Various governance arrangements are possible to recognise this distinction. Two, for which there are already precedents in the financial sector, are:
- a) A single management board, responsible for both functions, and peopled by those with knowledge of investment and its administration. Just as the Financial Services and Markets Act provides for statutory Practitioner and Consumer Panels to advise it, so might there be a statutory panel to represent stakeholder interests, such as employees, employers and consumers, which the board would be required to consult about all major decisions.
  - b) A widely constituted board, with representatives of all stakeholders responsible for the management of the scheme, but with a separate body of experts responsible for investment. Both would report separately to Parliament. This model might be seen as akin to the roles of, respectively, the Court and the Monetary Policy Committee of the Bank of England, where the former is responsible for resources and management, and the second for the specialist monetary policy function.
19. It might be asked why a single unitary “board of trustees” would not work, as it does in occupational pension schemes. The answer lies in the unique,<sup>2</sup> national role that the NPSS would have, and the importance for both Government and members of keeping investment matters away from the political process. But at the same time there are likely to be demands for a stakeholder say in the administration of the

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<sup>2</sup> Trustee Boards in occupational schemes have a narrower function than NPSS would – for example NPSS would have both responsibility for the overall costs of the scheme and for the net return on investments, which introduces a potential conflict which does not exist in many occupational schemes.

scheme, and that such aspects should not be left solely to investment professionals. Hence the need to reflect both considerations in the structure. Moreover, even in an occupational scheme, it is common to have an Investment Committee rather than the full Board of Trustees, in charge of investment.

20. Long-term confidence in the scheme would, in our view, be enhanced if the investment decisions were the sole responsibility of a group of experts, the members of which would be recognised as skilled in investment matters and whose single focus was in choosing strategies and managers to achieve the savings objectives of the scheme. This separation would make it clear that the investment decisions were based on the 'best available knowledge and experience', focussed solely on meeting the forward looking savings objectives, and that the application of this advice was unfettered by any other considerations. Credibility of the scheme, and hence willing participation, will require it to be regarded as the 'best institutional management available' rather than 'cheap and cheerful'.

### **The role of Government**

21. The Government would be responsible for appointing the NPSS Board, and other bodies, depending on the precise governance arrangements established.
22. If NPSS is to be a successful national savings scheme, an important starting point is a broad and clearly understood investment goal. It would not be satisfactory to auto-enrol individuals into a funded pension scheme (of whatever design) without some objective beyond simply raising savings levels.
23. This is particularly the case given the nature of the target market – millions of workers on median earnings and below, who may not be experienced investors and may be nervous of exposure to substantial market risk. While the market risk is in fact primarily concentrated at the end of the savings period (at the moment of being an enforced seller to purchase an annuity)<sup>3</sup>, perceptions and fears of risk as a result of exposure 'to the markets' need to be minimised. One way of achieving this is to define clear underlying savings objectives for NPSS, such as a long-term link between fund growth and wage growth.<sup>4</sup>
24. However constructed, this savings objectives needs to be given to the NPSS by Government as part of its remit. The statutory duty of care would be too broad to give the NPSS adequate guidance as to what it is expected to achieve in its investment of the assets of the scheme, in particular the default fund. This remit has to be given by Government. It would then be for the NPSS to decide how to fulfil this remit, including in particular the appropriate diversification across asset classes, fund managers and investment strategies to achieve it.
25. In pursuing the objectives, the NPSS might also be asked within the remit to maximise returns of the scheme as a whole while ensuring that individual investors did not suffer a serious fall in the value of their funds in the run up to retirement.

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<sup>3</sup> It is the purchase of the annuity that provides the pension; before that 'pension' products are essentially long term savings products with a lock in until retirement.

<sup>4</sup> Such an objective would be consistent with an overall approach to pension provision in which the State through a combination of pension and benefits ensures an appropriate minimum level of welfare for its citizens in retirement and individuals make their own lifestyle decisions in excess of that.

The latter part of this would be difficult to express in legal language that did not have a perverse impact on investment strategy in the event of unexpected market movements. The Pensions Commission in its report refers to this as 'lifestyling' – in practice, different approaches are possible and the decisions about which to use should be left to NPSS.

26. These are in large measure technical investment issues on which the NPSS will need to be able to take a properly informed view. Investment conditions can change quickly and it may need in some circumstances to act with alacrity. This means that its ability to act in the best interests of investors should not be unreasonably constrained by its statutory powers.

### **Communication and Education**

27. The NPSS would be responsible for communication with investors, with respect to two sets of choices:
- Whether to opt out.<sup>5</sup>
  - Whether to be part of a default scheme or to choose other investment options available (assuming the Board decided to offer a range of choices).
28. Like the present stakeholder regime, NPSS would operate without formal financial advice. As in the current stakeholder basic advice regime, the individual decision whether to be part of the scheme (in this case, 'opting out' rather than 'in') would be achieved with the help of a decision tree and accessible literature explaining how the scheme operates.
29. With respect to fund choice, NPSS would need to deliver literature that explains in simple, informative terms what is involved and what the potential risks are. This is a difficult area, given that any further direct assistance (for example, call centres) could be construed as advice, with potential legal implications.
30. The communication issue raises the broader question of general financial literacy and education. There is a clear need for Government action on this issue beyond the specific requirements that may emerge from NPSS in order better to equip citizens to take advantage of appropriate products offered by the financial services industry.
31. Given these difficulties, IMA believes that initially at least, the NPSS Board may choose to offer a limited range of choices in its investment options (described in more detail below).

### **PART II: Investment**

32. The NPSS would oversee the fund choice offered to individual participants. A critical part of this would be the design of the default fund, which experience from DC

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<sup>5</sup> While IMA takes no specific view on the current interaction between state pension arrangements and private saving, it recognises that for NPSS to be successful, some simplification of the system may be required.

schemes internationally suggests would be the destination for a large proportion of NPSS contributions.

33. A spread of both investment risk within individual NPSS funds and of fund manager risk is strongly recommended. Thus, components of a default fund could be managed with a diverse range of assets and investment styles, and by a number of different managers (effectively, a multi-manager fund). The default fund effectively offers individual retirement accounts from the point of view of the scheme member, but scheme assets are managed collectively in a multi-manager fund.
34. Managers would be appointed through open competition on a minimum 5 year basis. An individual's investment would therefore be spread across all the managers of a particular fund type. There are a number of advantages to such an arrangement:
  - Diversification. It provides diversification of fund manager risk.
  - Competition. It provides competition between managers for mandates.
  - Corporate governance independence. It distances the NPSS from issues related to individual securities, for example takeovers and mergers, and individual company concerns, for example corporate governance and executive pay. These decisions would be spread over a number of fund managers, each making their own judgments solely on the basis of their individual views of the impact on future investment performance. The NPSS would, however, have to set the general policy parameters within which such decisions are made, just as a large occupational pension fund would. A likely minimum requirement it might make is for UK companies to report on how they apply the Combined Code on Corporate Governance. Certain NPSS funds might be established with more detailed policies, for example based on Corporate Social Responsibility criteria.
35. NPSS should expect managers to bid on a professional basis, for example, backing their bids with analysis which shows how their particular approach might best deliver the savings objectives of the scheme, including detailed modelling and stress testing. NPSS would also be responsible for monitoring the performance of its appointed managers and the overall performance of the fund(s) in relation to the remit set by the Secretary of State
36. None of this should preclude the NPSS from including funds other than its own. Certainly, in the early years, there is likely to be an overwhelming preference for a default arrangement, particularly in view of the target market for the NPSS. How quickly to admit non-NPSS funds, and in what way, should, like other investment issues, be a matter for the NPSS to decide.

### **Investment management innovation**

37. Investment management techniques have evolved steadily over the last few decades and continue to do so. From the recognition of the role of equities in pension fund investing in the 1950s and 1960s, through the development of index tracking in the 1970s, and latterly lifestyling and liability-driven investment, to today's sophisticated use of derivatives to reduce risk and diversify alpha, new techniques have been

developed. It can be expected that that process will continue, so that the approach to investing within the scheme needs to be “future proofed”.

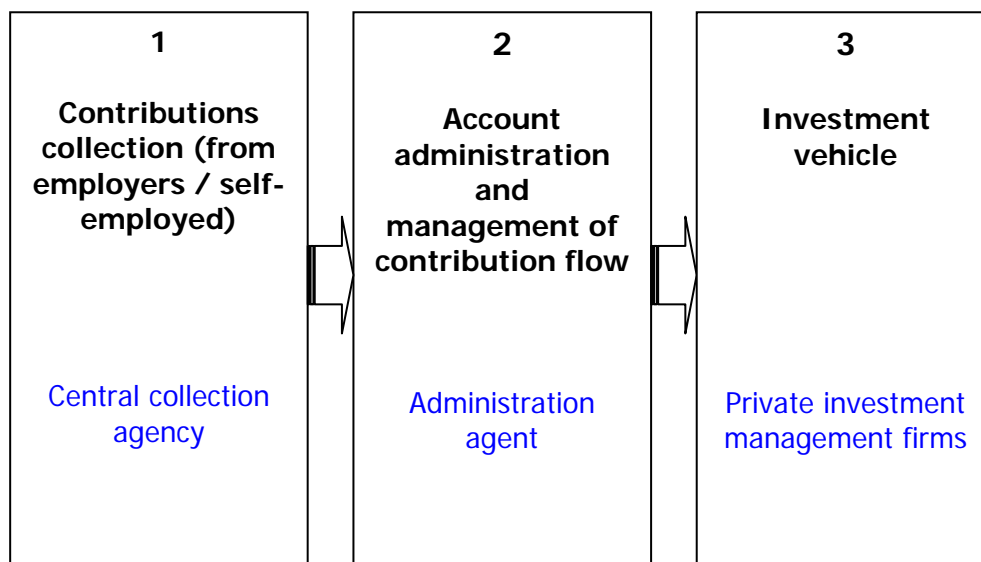
38. Within that market today, a distinction is drawn between two distinct forms of investment return – “beta”, which is the market return, and “alpha” which is the extra return that the fund manager succeeds in creating by exploiting mis-pricing and other inefficiencies in the market. The achievement of high alpha is perceived to be more difficult as portfolio size increases.
39. “Beta” investing involves delivering as close a match as possible to market return, at minimum cost. Economies of scale can be achieved here that would allow the kind of ‘bulk purchasing’ described in the Pensions Commission’s Second Report to push down the asset management charge.
40. However, a strategy that involves only “beta” investing is likely to deprive investors of the opportunity to benefit from the expertise of many asset management firms who specialise in generating extra return through alpha generation. A number of innovative techniques have emerged in recent years – often used, to varying extents, by occupational funds – which provide access to such alpha returns. There is no reason why NPSS should not also employ such techniques.
41. With respect to fees, substantial economies of scale are not necessarily available for actively managed equity and bond funds. How far they are will depend on the investment strategy and the characteristics of the market in question. While fees for active management may decline for larger mandates, they do not reach the very low levels seen for index funds.

### **Ownership**

42. Alongside good governance, it is important that participants feel that they have a direct relationship with their pension investments. In practice, this means three things: being able to know what their individual holdings are worth; understanding the potential purchasing power in pension terms; and being assured that they are the owners, and that neither future changes of Government policy nor problems within participating fund management companies would threaten that.
43. These goals could be achieved if the fund or funds were based on the principle of daily unit pricing and a clear legal ownership structure. We outline what this would mean in practical terms in Appendix II.

### **PART III: Connecting the citizen to the savings vehicle (plumbing)**

#### **Accumulation Phase: Long-term savings vehicle**



44. In its simplest form, the mechanics of the accumulation phase of a long-term savings product involves three key tasks: (1) collecting contribution payments, (2) administering the flow of contributions and (3) investment management.
45. The investment management industry's primary concern is with (3). However, we feel that the way in which elements of our members' business is currently administered offers clear signals as to how best to construct an investment administration agent, which could at a minimum administer and manage the flow of contributions. Depending on how the system is designed, it might additionally be involved in contributions collection.
46. The core activities of the administration / investment interface are the aggregation of investment orders on behalf of individuals, the passing on of aggregated purchases and sales to the managers involved in the investment vehicle, and maintaining records of holdings, both in aggregate, and by individual holders. It would also communicate with individual holders. This looks very much akin in the UK to the services provided by fund supermarkets/transfer agencies and suggest that the infrastructure to provide such services already exists in the private sector. A fuller description of this is provided in our earlier technical paper submitted to the Pensions Commission.
47. While such infrastructure could not just be provided in an 'off the shelf' form to run function (2) in NPSS, its existence should help to assuage fears that NPSS would involve costly systems set-up challenges of the kind experienced in some Government IT procurement / agency establishment projects. One large administrator has estimated that a system could be set up with initial costs of up to £20 million.

48. The collection of contributions largely falls to employers via payroll deduction. In these circumstances the collection agency is effectively a receiver of contributions. There need to be mechanisms to ensure that the amounts received match those deducted by the employer and that the employer's contribution is also the correct one. Contributions are likely to be offset against tax (the Pensions Commission assumption): this would point to an involvement of HMRC in monitoring compliance irrespective of whether or not it is also the collections agency.
49. As part of its verification responsibility the collections agency will need to be able to track employees across different employers and as they move around the country. Again this is a task that is already undertaken by HMRC in its relations with employees and individual employers. A key decision for Government would be whether to build on HMRC's existing reach in the 4 year run up to the introduction of NPSS or to look to a new administration to fulfil these functions.
50. One major reservation we have about the possibility of a new collection agency is the impact it might have on small employers' incentives to either encourage or discourage participation in their workforce. Adding another collection system in addition to PAYE might put at risk the achievement of high participation in the scheme.

#### **Decumulation Phase: From long-term saving vehicle to pension**

51. The accumulation phase in the NPSS, as in any defined contribution scheme is essentially not a pension, but a long-term savings mechanism with a lock-in until retirement. This means that it can be dealt with by practices and administrative systems that largely already exist in the investment management world today. But IMA strongly recommends that the Government also considers the mechanisms to be employed during the decumulation phase (the period that actually involves the delivery of a pension).
52. It is assumed that the accumulation phase ends at the state retirement age, and at that point there would be an appropriate transfer from the investment vehicle to an annuity provider, and that this transfer would be subject to the same tax arrangements as other pension vehicles i.e. currently that an individual can take out up to 25% of his or her 'fund' as a tax cash free lump sum with the remainder used to purchase an annuity.
53. The obligation to buy an annuity exposes the individual to significant market risk. This has two sources: first as an enforced seller of investments at a single point in time, second as an enforced buyer of the annuity at the annuity rates that prevail at that time. The second is recognised in the flexibility introduced through permitting the annuity purchase to be delayed to any point between retirement age and reaching the age of 75. However, this flexibility is likely on average to be of little value to those at or below median earnings who may not be able to defer receipt of the additional pension.
54. Although not a new issue in relation to annuities and pensions, the potential expansion of this type of arrangement to the wider population perhaps merits an examination of whether this risk can either be further mitigated or at least made more transparent.

## **Part IV: Costs**

55. As experience of the occupational pensions sector has shown, the impact of competition in the form proposed in this paper can lead to low costs and good value for money for investors. The Pensions Commission's Second Report estimated that large scale occupational schemes could be run for annual management charges as low as 0.1-0.3%.<sup>6</sup>
56. In this context, there are three main elements of overall cost: collection, administration and asset management. Collection involves receiving money deducted by employers from payroll, verification and compliance. Administration encompasses four central elements: individual account administration, routing the investment flow, fund accounting and communication with participants.

### Administration.

57. As regards administration costs, much will depend on the detailed design of the scheme. A range of factors could considerably increase operating costs: for example, a high level of switching between funds and/or intensive demands on call centre facilities. Costs in this area are best discussed in unit terms, rather than an ad valorem basis, which can be distorted by factors such as the scale of the scheme. A leading provider has estimated the equilibrium cost of administering NPSS accounts at £5-£8 per account (this would cover individual account administration, routing the investment flow, some communication with participants, but not fund accounting). This is not inconsistent with experience in Sweden where costs per account are around £3-5.

### Asset Management.

58. It would be a mistake to set an arbitrary overall cap on costs from the outset. In all investment, it is net performance that matters. If higher charges in some areas of the portfolio could improve net performance or reduce overall risk, that should not be precluded.
59. Within the institutional asset management market, passive management fees are frequently well below 10 basis points depending upon size and the nature of stock lending arrangements. Fees for active management range tend not to fall below 15-25 basis points, and may involve a level of performance fee in addition.
60. If active management is successful, the potential out-performance could reduce effective costs in net terms to zero or even less. As with other asset allocation decisions, the balance between active and passive mandates, and the use of performance fees as an incentive, should be a matter for the NPSS itself to decide.

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<sup>6</sup> Pensions Commission Second Report, Main Report, p.110

61. Our view is that there is scope for both forms of management within the choices made by NPSS in its manager selection process.

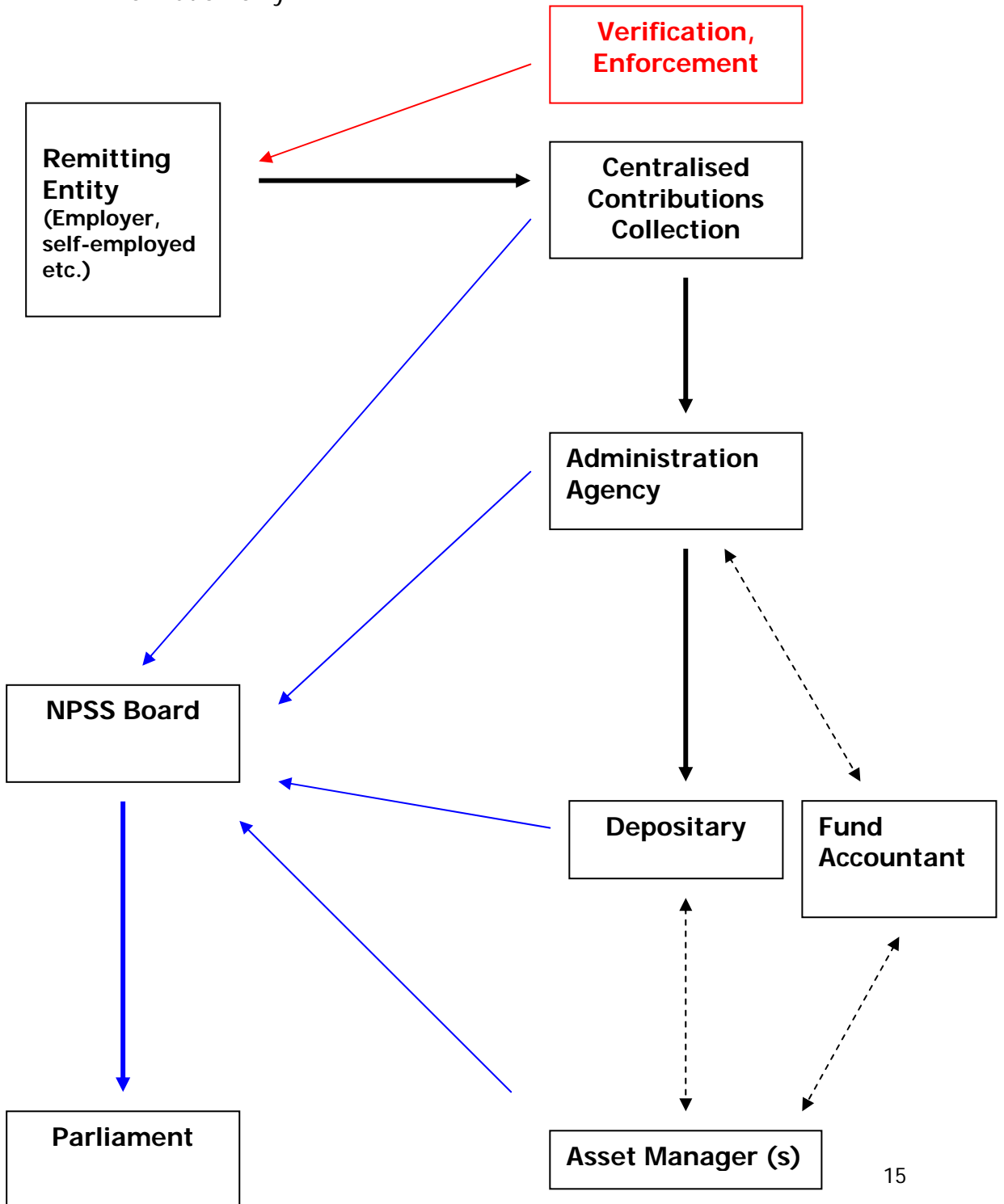
#### Overall Costs

62. We understand the DWP has commissioned independent analysis of cost structures and likely charges. Our judgement is that the overall cost (including collection) is likely to be no more than 50 basis points.

63. It is important, however, that the scheme should not be designed with the sole purpose of minimising cost. Competition in the provision of fund management and other services will ensure that costs are at an acceptable level. The watchword for investors should be value for money, and this should be one of the criteria against which performance of the scheme should be judged.

# APPENDIX I: ACCUMULATION (SAVINGS) PHASE: CONTRIBUTIONS FLOW AND ACCOUNTABILITY

- Lines of accountability
- Contribution flow
- - - Information only



## APPENDIX II: Ownership Structures

The unitisation and legal ownership structures proposed for NPSS are borrowed from the unit trust / OEIC world (even though the investment management approach would be closer to the current institutional than retail world).

### 1. **Unitisation**. First, the fund or funds should be unitised:

- A unit represents a fixed share in a fund. The total value of a fund is the sum of the market values of the investments held in the fund. At the point of its creation, a fund needs to decide what the initial price of a share in the fund will be (£1 is a frequent choice): the initial number of units/shares is then the initial value of the securities held in the fund divided by the initial price.
- The value of a unit is directly related to the market values of the securities held in the fund. As new money flows into a fund, new units are created using the then unit price: for example, whereas initially £50 might have bought 50 units at the creation price of £1, if the market values of the securities were to subsequently rise by 10% say, £50 would buy approximately 45 units and if it were to go down by 10%, then £50 would buy 55 units.
- Where inflows to the fund come in differing amounts at different times and on behalf of different individual holders, accounting in units is a convenient way of attributing at any point in time shares in the fund back to individual holders on an equitable and transparent basis.
- Units should be priced daily and could be published daily. Industry wide standards for performance measurement and cost measurement aimed at ensuring fair comparisons between managers are already in place.

### 2. **Established legal structure**. Second, the fund or funds should have an established legal structure that protects the end investor against failure or fraud in the fund management company:

- The assets of the fund would not be owned by the fund management company; they would be owned by a depositary or trustee who acts on behalf of the underlying investor and is independent of the fund management company.
- The depositary would control the creation and redemption of units.
- The depositary would have oversight of all the actions of the fund manager in his dealings with the fund.

### 3. **Detailed regulation on investor protection**. Third, the management and operation of the fund should be governed by existing detailed regulation focussed on investor protection, which for example:

- requires fund accounts to be prepared and audited to an established, publicly available and approved accounting standard;
- determines what can and cannot be charged to the fund; and
- circumscribes the fund manager's activities.

Establishing the NPSS along these lines would help to promote the sustainable credibility essential for the Scheme to develop in the longer term.