



## **RESPONSE OF THE ASSOCIATION OF CONSULTING ACTUARIES TO THE MYNERS REVIEW OF INSTITUTIONAL INVESTMENT**

### ***Introduction***

The Association of Consulting Actuaries (ACA) draws its membership from individual consulting actuaries working in over 80 consulting firms. Members of the Association are all qualified actuaries - mostly either Fellows of the Institute of Actuaries or Fellows of the Faculty of Actuaries in Scotland - and all actuarial advice given by members is subject to the code of conduct of the Institute and Faculty of Actuaries.

The vast majority of the country's largest pension schemes are advised by ACA members and they, amongst thousands of other smaller pension funds, companies and organisations take advantage of a wide and varied range of services offered by our members.

On the investment front, members advise on investment objectives and on asset allocation strategies appropriate to these objectives, taking into account the particular scheme's liabilities. They will analyse and monitor investment performance of the pension fund and advise on the selection of investment managers when required.

### ***Overall comments on the report and proposals***

The Myners Report is a good in-depth study of UK institutional investment – in particular occupational pension schemes. UK occupational pension schemes have been a success story, and many other countries that are moving towards funded pensions provision are borrowing elements from the UK approach.

The Report highlights a number of areas where the investment strategy and decision making of UK pension funds could be improved. It makes many sensible proposals for improving the clarity and quality of investment decision-making by trustees. We welcome the Government's decision to adopt these proposals as a code of conduct rather than by implementing prescriptive legislation.

The Myners Report and suggested principles for the code of conduct do not distinguish between pension schemes of different sizes. It may be unrealistic to expect smaller schemes to follow all of the recommendations as closely or in the same level of detail as larger schemes.

Defined benefit pension provision has come under severe pressure from increasing costs in recent years. There is potentially a risk that, if the costs of meeting best practice are too high, it may discourage some employers (particularly smaller ones) from future defined benefit pension provision. Flexibility is needed in the implementation of the code if we are to avoid this.

### ***Minimum Funding Requirement (MFR) and distortions to investment decision making***

The Report expresses a concern that the MFR has caused distortions in the investment decision making for UK pension funds. Following the Review, the government has accepted this recommendation and announced its intention to abolish the MFR.

The MFR has influenced investment decisions and from an investment point of view its removal is welcome. However, its removal will not change pension scheme liabilities. The increasing maturity of pension schemes will remain a fact, and trustees will need to take account of this in setting investment strategy. The new FRS 17 accounting standard for pension costs may also have an impact.

### ***Trusteeship and investment decision making***

The Myners Report suggests high standards should be expected of Trustees. From what we have seen of Trustees in the UK, they do take their task seriously and should be applauded for their efforts. However, the Report is correct in suggesting there are many areas where standards of decision-making could be improved. We agree with the assertion that many trustees do not spend enough hours on investment issues.

For many trustee bodies, setting up investment sub-committees could help to ensure that investment issues receive proper consideration before decisions are taken. Investment sub-committees are often selected from the trustees that have more experience in investment issues. However, under trust law all trustees still retain a personal responsibility for decision-making. So in most cases the sub-committee will do no more than make recommendations, which then need confirmation by the full trustee body.

The Report makes a suggestion that trustees should be paid. Most trustees are already paid employees of the sponsoring employer, who are allowed paid work time to carry out trustee duties. Probably an expectation of more time to be given to trusteeship and provided for trustees by employers is more realistic than a proposal for payment. Some schemes do appoint paid trustees that are independent of the scheme and that have experience in investment matters. Professional trustees can help to improve the quality of decision-making. However there is also a risk that some professional trustees may be very risk averse in making investment decisions because they are concerned to limit their own potential liability if anything goes wrong.

At present, Trustees rely heavily on independent investment advice for investment decisions. This is appropriate and it would be unfeasible for all trustees to become expert enough not to rely on such advice. It is agreed that they should have the knowledge to assess critically the advice they receive but, in the end, they are still likely to follow the advice in most instances.

We wholeheartedly support the call for more investment training for trustees, which would clearly improve the quality of decision-making. It is probably not workable to require trustees to obtain any sort of formal investment qualification, because this could act to discourage many people from taking on trustee responsibilities. Some sort of investment training guidelines could be incorporated into the code of conduct as best practice, and subject to self-regulation.

### ***Statement of Investment Principles***

The proposal to strengthen the Statement of Investment Principles (SIP) is appropriate as are the detailed suggestions. The SIP would be a more useful document if it clearly set out the framework for trustee decision-making and the scheme's investment arrangements. This is often not the case at present.

However, the inclusion of projected investment returns in each asset class may be detrimental. In reality, the returns will be vastly different from projected and may mislead members to believe the investment strategy has not been effective.

It would be preferable for the Statement to be available for any member who requested it as at present rather than automatic distribution to all members. Information overkill would not be beneficial. The key points from the Statement might be summarised in existing communications to members.

We agree that there should be a review of how to apply these investment principles to life assurance companies. This is primarily an issue for with profit products because there is not a direct link between the bonuses attributed to a policy in a year and the return on the underlying fund. This issue was considered by the Faculty and Institute of Actuaries Transparency Working Party earlier this year. We believe that this should be brought within the scope of the FSA's own review in this area.

We do not agree that there needs to be an independent review of capital and information flows around personal investment products. The provision of information at the point of sale of such products has been subject to a number of changes over recent years and we believe that, together with the FSA's Conduct of Business rules, the current regime provides consumers with sufficient protection against inappropriate advice. Further, the FSA's own research has shown that there is little correlation between historic investment performance and the future, and so we support the FSA's initiatives to place less emphasis on this area.

### ***The role of Investment Consultants***

The Review calls for a separation of the role of Scheme Actuary and Investment Consultant. The decision on how to tender for the provision of these services and whether to bundle them together is a commercial decision for trustees to take. There are advantages and disadvantages to both approaches.

We agree that trustees should define separate terms of reference for actuarial work and for investment advice. It should then be up to individual trustee bodies as to whether they see merit in obtaining separate tenders for these services or whether they choose to bundle them with one provider. Where separate appointments are made for actuarial work and investment consultancy, there will need to be close contact between the Scheme Actuary and the Investment Consultant, to ensure that the scheme's liabilities are taken into account in setting an appropriate scheme-specific asset allocation benchmark.

It is also suggested that trustees measure investment consultants' performance. The NAPF has just published a helpful starting point in this regard. Clear terms of reference for consultants would be beneficial. Meaningful measurement of the effectiveness of their advice will remain hard to achieve. There are many aspects to the value that can be added by investment consultants, some of which are difficult to quantify.

Evaluation of the performance of investment consultants and the quality of trustee decision making may be best achieved by some sort of a due diligence process. If trustees and investment consultant produce a clear framework for investment decision-making, then compliance with this framework and with the code of practice can be monitored on an ongoing basis.

### ***Mandates and Benchmarks for Investment Managers***

Investment manager agreements should already set out the benchmarks and investment objectives that have been set for the manager. Most trustees will rely heavily on advisers to help them determine a suitable investment manager structure.

We support the principle of clean investment management fees. We support greater clarity in dealing costs. Incorporating brokers commissions in to the fund management fee may help here. However there may be a risk that transaction costs are hidden in other ways, e.g. fund managers might move to dealing net of commission, but end up paying higher bid/offer spreads as a result. This proposal needs further consideration before implementation.

We do not support the proposal that investment manager mandates should not be terminated before the expiry of the evaluation timescale. The investment agreement between trustees and investment manager is a commercial contract, which should not be subjected to artificial constraints. The review suggests limited circumstances in which it would be acceptable to terminate a mandate early, but in practice there are all sorts of valid reasons trustees might wish to terminate the mandate, and we do not believe the code of practice should be prescriptive in this regard. In any case, we are not convinced that investment managers would carry out their investment responsibilities differently if they had this protection.

### ***Defined Contribution Schemes***

It is proposed that trustees should offer a wide enough range of DC fund options to satisfy the reasonable risk and return combinations appropriate for most members, taking members' preferences into account. How are members' preferences to be determined? Trustees will not be aware of all members' individual circumstances - would there need to be some sort of consultation of members? This could become very complex and difficult to administer. Trustees also need to consider whether some members' preferences may be inappropriate for their circumstances (for example a 20 year old investing all contributions in a building society account).

Trustees can provide information and education as they consider appropriate to enhance members' knowledge, but cannot provide investment advice on choice of investment funds.

### ***Activism***

The Report is proposing that investment managers take greater responsibility for the management of the companies they invest in. We support the proposal that investment managers should have a clear strategy in this area. It may be quite difficult in practice to measure the effectiveness of the strategy.

### ***Private equity***

We agree that trustees should consider private equity investment, as they should all major asset classes and investment opportunities available. The degree to which individual schemes

choose to invest in private equity investment in its various forms, or not as the case may be, will be very dependent on scheme-specific circumstances.

Private equity investment has a part to play for larger pension schemes. However, it is less practical for smaller schemes and schemes investing in pooled funds. Time constraints, liquidity and higher investment costs are all important constraints – particularly for smaller funds.

It should not be assumed that the removal of the MFR would in itself encourage more private equity investment. It should be respected that Trustees may choose not to invest in this asset class and it is certainly not appropriate to force them to do so given the risks involved.

We support the proposals made regarding life insurance companies to give them greater freedom in this area. As for pension schemes, the degree to which individual companies choose to invest in private equity investment in its various forms will be very dependent on company-specific circumstances.

### ***Conclusion***

We support the adoption of the Principles outlined in the Myners Report as a code of conduct, allowing pension schemes to retain flexibility in the implementation of the proposals. We believe the industry would benefit if the following specific changes and points of clarification were made to the Principles in the code of conduct:

- Trustees should be given flexibility to use in-house staff for investment staff or to outsource this function to an investment consultant
- We support the incorporation of guidelines on investment training for trustees, but do not believe there should be a minimum level of investment qualification required for trustees
- Trustees should only be required to provide members with a copy of the Statement of Investment Principles on request (a summary of key points might be included in regular communications)
- We do not support the proposal that investment manager mandates should not be terminated before the expiry of the evaluation timescale.

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