

BBS investment update

Myners Update

Background

In March 2000, the Chancellor of the Exchequer, Gordon Brown, commissioned Paul Myners to conduct a review of institutional investment in the UK. Paul Myners served as chief executive and chairman of leading fund manager, Gartmore, and subsequently became Chairman of Marks & Spencer plc and, in 2008, Financial Services Secretary in the Treasury with a well publicized involvement in the bank rescue package.

In his report, published in March 2001, Myners recommended that defined benefit pension fund trustees voluntarily adopt, on a 'comply or explain' basis, a series of ten principles (eleven for defined contribution schemes) as a best practice code for investment decision-making. The Government accepted Myners' recommendations, and agreed that a further review of how the principles operated in practice should be carried out in 2004. The 2004 review concluded that the Myners' principles had resulted in an improvement in trustee performance, albeit with greater progress in some areas than others.

In 2007, the Government asked the National Association of Pension Funds (NAPF) to carry out a further review, and following this review and consultation with HM Treasury, a final response has now been issued by the Treasury.

Changes to the Myners' Principles

The Government's response has been to simplify and condense the ten principles into six higher-level principles. The principles are supported by best practice guidance and a range of trustee tools which trustees and advisers may use to assess the extent to which they are complying with the principles and how they can best apply the 'new' principles in practice.

The revised set of six principles, best practice guidance and trustee tools are set out in full in the Appendix to this Investment Update.

Compliance with the principles remains voluntary; and we do not expect the principles to become legislative requirements. It is expected that trustees will demonstrate their compliance with the principles on a 'comply or explain' reporting basis, as follows:

- under a 'comply or explain' model, it is not expected that there will be mandatory compliance for all the principles, but that trustees will either comply or provide an appropriately detailed explanation as to why they have taken a different approach;
- trustees are expected to report on the application of the principles, not the supporting best practice or use of the trustee tools, as the latter exist to support trustees' application of the principles;
- the form and content of trustees' reporting should not be prescribed;
- disclosure is not aimed solely at the members of the pension scheme, but also at the wider trustee community to help develop and spread best practice.

In practice, trustees might choose to provide information in their Statement of Investment Principles, a scheme's annual report and accounts or through a periodic update to scheme members.



BBS investment update (continued)

Investment Governance Group

As part of the ongoing review, the Government has announced that it will set up a joint Government-industry Investment Governance Group (IGG). The IGG will take ownership of the principles and be responsible for both the best practice guidance and providing further practical trustee tools.

The IGG has been asked to address a number of areas where further guidance may be required, and we expect their initial focus to be as follows:

- brief and practical guidance on how trustees might wish to report their compliance with the principles;
- the principles for defined contribution (money purchase) schemes which have not yet been considered within the current review;
- the application of the principles for smaller schemes and whether a tailored set of principles with associated guidance from the IGG would be appropriate;
- the needs of the Local Government Pension Scheme.

Issues for smaller schemes

The problems associated with smaller schemes (defined as schemes having fewer than 500 members) adopting all the Myners' principles were recognised at the time of the initial report, as the main focus of the Myners' report was on the investment governance of larger pension schemes. The Government's view, however, was that smaller schemes should not be exempt from the principles but that they should attempt to disclose to members the areas of non-compliance and the reasons why.

In our view, smaller pension schemes are already generally compliant with the key new principles such as effective decision making, setting clear objectives and understanding the risks associated with the valuation of the liabilities and issues such as sponsor covenant and longevity risk.

Where trustees of smaller schemes often find it more difficult to demonstrate effective compliance is in areas such as 'responsible ownership', where the options available to trustees investing in index-tracking funds or pooled funds will often be limited.

Trustees and sponsoring employers will also want to ensure that effective compliance with the principles, while important, is not to the detriment of incurring unnecessary fees and costs that might be better channelled to the pension scheme itself.

At this stage, therefore, our view is that it seems sensible to wait for further 'smaller scheme' guidance from the IGG before trustees undertake a detailed review of their compliance with the six high-level principles set out in the new guidance. BBS will keep you informed about the progress of the IGG and provide a further update in due course.

In the short-term, however, trustees may wish to note the updated principles at their next formal trustees' meeting and consider briefly to what extent their own scheme already complies with the six principles.

If you have any questions in connection with the above, please contact your usual BBS consultant or Iain Fitzgerald.

BBS Consultants & Actuaries LLP
March 2009



APPENDIX: TABLES OF UPDATED PRINCIPLES, BEST PRACTICE GUIDANCE AND TOOLS

Principle	Best practice guidance	Trustee tools
<p><i>The high level principles will be the accepted code of best practice throughout the industry in investment decision-making and governance. It is expected that trust boards will report against these on a voluntary 'comply or explain' basis.</i></p>	<p><i>Best practice guidance is intended to help trustees to apply the principles effectively.</i></p> <p><i>Trustees are not expected to implement every element of best practice. Rather trustees may use best practice examples where appropriate to help demonstrate whether compliance has been achieved.</i></p>	<p><i>Tools provide practical help and support to trustees and their advisers to enable them to apply the principles and ensure that standards of investment decision-making and governance continue to rise.</i></p>
<p>Principle 1: Effective decision-making</p> <ul style="list-style-type: none"> Trustees should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation. Trustees should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest. 	<ul style="list-style-type: none"> The board has appropriate skills for, and is run in a way that facilitates, effective decision-making. There are sufficient internal resources and access to external resources for trustees and Boards to make effective decisions. It is good practice to have an investment sub-committee, to provide the appropriate focus and skills on investment decision-making. There is an investment business plan and progress is regularly evaluated. Consider remuneration of trustees. Pay particular attention to managing and contacting with external advisers (including advice on strategic asset allocation, investment management and actuarial issues). 	<ul style="list-style-type: none"> TPR's Trustee Toolkit and other training material Publication of best practice guidance / templates e.g. in relation to business plans, scheme structures etc. TPR guidance on conflicts of interest. Publication of industry-average lay-trustee remuneration.
<p>Principle 2: Clear objectives</p> <ul style="list-style-type: none"> Trustees should set out an overall investment objective(s) for the fund that takes account of the scheme's liabilities, the strength of the sponsor covenant and the attitude to risk of both the trustees and the sponsor, and clearly communicate these to advisers and investment managers. 	<ul style="list-style-type: none"> Benchmarks and objectives for the funding and investment of the scheme. Fund managers have clear written mandates covering scheme expectations, which include clear time horizons for performance measurement and evaluation. Trustees consider as appropriate, given the size of fund, a range of asset classes, active or passive management styles and the impact of investment management costs when formulating objectives and mandates. Consider the strength of the sponsor covenant. 	<ul style="list-style-type: none"> TPR guide on covenant assessment. TPR Trustee Toolkit. IMA Pension Fund Disclosure Code. Marathon Club Guidance for Long-Term Investing
<p>Principle 3: Risk and liabilities</p> <ul style="list-style-type: none"> In setting and reviewing their investment strategy, trustees should take account of the form and structure of liabilities. These include the strength of the sponsor covenant, and the risk of sponsor default and longevity risk. 	<ul style="list-style-type: none"> Trustees have a clear policy on willingness to accept underperformance due to market conditions. Trustees take into account the risks associated with their liabilities valuation and management. Trustees analyse factors affecting long-term performance and receive advice on how these impact on the scheme and its liabilities. Trustees have a legal requirement to establish and operate internal controls. Trustees consider whether the investment strategy is consistent with the scheme sponsor's objectives and ability to pay. 	<ul style="list-style-type: none"> TPR guide on working with the employer. Code of practice No 3 on Funding Defined Benefits. Code of practice No 9 on Internal Controls. TPR guidance on longevity.



BBS investment update (continued)

<p>Principle 4: Performance assessment</p> <ul style="list-style-type: none"> Trustees should arrange for the formal measurement of the performance of the investments, investment managers and advisers. Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members. 	<ul style="list-style-type: none"> There is a formal policy and process for assessing individual performance of trustees and managers. Trustees can demonstrate an effective contribution and commitment to the role (for example measured by participation at meetings). The chairman addresses the results of the performance evaluation. State how performance evaluations have been conducted. When selecting external advisers take into account relevant factors, including past performance and price. 	<ul style="list-style-type: none"> Trustee 'Key Performance Indicators'. TPR's Trustee Toolkit. Assessing consultants performance 'toolkit' e.g. model balanced scorecard etc.
<p>Principle 5: Responsible ownership</p> <ul style="list-style-type: none"> Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents. A statement of the scheme's policy on responsible ownership should be included in the Statement of Investment Principles. Trustees should report periodically to members on the discharge of such responsibilities. 	<ul style="list-style-type: none"> Policies regarding responsible ownership are disclosed to scheme members in the annual report and accounts or in the Statement of Investment Principles. Trustees consider the potential for engagement to add value when formulating investment strategy and selecting investment managers. Trustees ensure that investment managers have an explicit strategy, setting out the circumstances in which they will intervene in a company. Trustees ensure that investment consultants adopt the ISC's Statement of Practice relating to consultants. 	<ul style="list-style-type: none"> Statement of Investment Principles. ISC Statement of Principles. Supporting statement for investment consultants on the ISC principles.
<p>Principle 6: Transparency and reporting</p> <ul style="list-style-type: none"> Trustees should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives. Trustees should provide regular communication to members in the form they consider most appropriate. 	<p>Reporting ensures that:</p> <ul style="list-style-type: none"> the scheme operates transparently and enhances accountability to scheme members; and best practice provides a basis for the continuing improvement of governance standards. 	<ul style="list-style-type: none"> Statement of Investment Principles including statement of funding principles. Websites / helplines (for larger schemes). Annual report and accounts. Best practice on quality disclosure and reporting.

