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Our Ref: 0430crlf.1

Dear Ms Skeet

**CONSULTATION DOCUMENTS ON RECOMMENDATIONS IN THE MYNERS
REPORT INSTITUTIONAL INVESTMENT IN THE UK: A REVIEW**

I am writing to respond to the consultation documents issued on 4 February 2002 in respect of the Myners Report. This response is on behalf of the Association of Consulting Actuaries (ACA). Our members advise the Trustees of nearly all Occupational Pension Plans in the UK on investment matters as well as actuarial matters. Thus, we are well placed to assess the impact of the Myners Report recommendations and the proposed regulations within the consultation documents.

This response is laid out in three sections corresponding to the three consultation documents.

1. *Pension Scheme Trustees being familiar with the issues concerned*

We agree with the main comment in the Myners Report that decisions should only be taken by persons or organisation with the skills, information and resources necessary to take them effectively. However, the attempts to codify in law a definition of being “familiar with the issues concerned” could cause problems. Firstly, additional requirements run contrary to the aim of ensuring more Member Nominated Trustees in Occupational Pension Schemes. The additional possibility of being challenged in the Courts due to these Regulations will not encourage further members to become Trustees.

The lack of a precise definition of the familiarity expected increases this problem. Indeed, the consultation document deliberately does not set this out in detail so as not

to constrain the flexibility of the standard of care, and to leave its interpretation to the Courts. This will leave a long period to elapse before any significant case law develops with Trustees uncertain as to precisely what standards they are supposed to reach in the meantime.

Addressing the specific questions in the consultation document in turn:

1. Most pension scheme Trustee Boards operate on collective decision for investment matters rather than separating these out into a Sub-Committee. However, the proportion of schemes using Sub-Committees for delegation is increasing. Sub-Committees have a clear advantage in efficiency of decision-making but it excludes other Trustees from some of the most crucial trustee matters, and for this reason is used in minority of schemes. It also can become unwieldy if there are different types of decisions for different types of Sub-Committees depending on its supposed complexity.
2. Any standard of care should apply collectively. For decisions delegated to Sub-committees it should apply to the Sub-committee collectively. If the duty of care applied to all trustees for decisions that have been delegated to Sub-Committees, then this would negate the rationale for having a Sub-Committee. The new standard should apply also to independent pension scheme trustees.
3. It would be helpful to have non-statutory guidance to supplement the proposed legislation as described.
4. It is not clear that there is much to be gained from fund managers and custodians also having a statutory fiduciary responsibility to pension scheme beneficiaries. Neither would it be problematic.
5. The proposals may have significant training implications. It is generally agreed that the Myners Report was correct to highlight the need for more investment training for trustees. The proposal of a statutory duty of care merely increases this further and makes it more likely that Trustee Boards will take the matter seriously. There may be considerable merit in an industry accreditation scheme as long as the reading material is not onerous. It will remain the case that most trustees are not paid for their trustee work and that employers allow employees time off from their duties to conduct trustee business. Therefore, well-written training material on investment matters would be useful within bounds.
6. The only advantage of enforcement being dealt with other than through the Courts would be to resolve matters more quickly, and at a lesser cost. However, rulings of the Occupational Pensions Regulatory Authority or the Pensions Ombudsman would still be challengeable in court and this would be likely to happen in cases of significant dispute. There will be many instances of decisions of the Pensions Ombudsman being overturned by the Courts as precedence of this. Therefore, it may be most practical for matters to be dealt with through the Courts as for the current prudent man principle of trustee decision-making.

In summary, the statutory duty of care may cause as many problems as it solves. Although the Myners Report was correct to highlight that trustees are very reliant on investment consultants, trustees generally show good judgement as to when they have understood sufficient detail to make decisions or when they should step aside and delegate decisions. Therefore, the proposals are addressing problems that are not acute. The industry needs more simplification rather than additional regulations that are not necessary. Nonetheless, if the Government intends to push through this matter the proposed definition appears reasonable, although further detail within the regulations or as non-statutory guidelines to explain further the standard of care required would minimise uncertainties and fear.

2. *Encouraging shareholder activism*

We support the objective of effective corporate governance with a strong part to be played by institutional investors. The Government's objective stated in paragraphs 15 and 16 appear reasonable. To answer the first stated question in the consultation document, it is problematic for the duty of activism to apply to trustees as well as fund managers. It is reasonable to expect trustees to agree a policy on activism as part of the fund manager's mandate, but it is not clear how the trustees should be able to monitor effectively the compliance of the fund manager other than periodic cross-examination and statements of compliance from the managers. The duty of the trustee should be merely to have an appropriate agreement in place with the fund managers.

Question 2 concerns non-pension funds. There appears no reason why such requirements should not apply to other funds as well as pension funds. The Government could declare a mandatory for all types of savings funds, such as life assurance funds, ISA funds etc. There is no theoretical reason why this should apply more to pension funds than other funds.

Question 3 concerns disclosure. It appears reasonable that trustees should report their policy on shareholder activism within either the Statement of Investment Principles or the Scheme Report and Accounts. We would hope that a brief description would suffice.

3. *Independent custodians and pension scheme*

In general, the requirement for us to have independent custody will represent little change. Most funds already do this.

Referring to Question 1, the advantages are those listed in paragraph 6 of the consultation document – i.e. to ensure that financial instruments are housed under a proper system of its investment for proper purposes with proper authority.

Referring to Question 2, those schemes which do not use a custodian have probably not considered this in detail. There may be a disadvantage in the small additional custodian charge, but this is normally relatively minor.

We believe that most would consider independent custodians better left as good practice rather than requiring legislation.

As paragraph 19 notes, requirement for independent custody may give a false sense of security given the poor record of such custodians in preventing fraud. Most trustees follow codes of good practice in any event.

Question 5 concerns other actions to improve security of pension fund assets. The weakest links are those at the employer or administration end rather than with the investment of assets. However, most schemes have tight arrangements based on signatory lists and good record keeping. The important chain of command is that between the trustees (or whoever is authorised to give instructions on their behalf) and the investment manager. This is referred to in Question 6 as well. The formal documentation as to who can provide instructions should be clear. In our experience, most fund managers operate tight procedures and will not undertake transactions without the appropriate authorisation.

Referring to Question 7. There may be some scope for detection in unusual movements in investment, but care must be taken not to cause additional costs to solve very unusual events. Often, a change in investment policy or instruction will require money being diverted to new accounts – this is not in itself unusual.

As suggested in Question 8, the requirement for more than one authorised person in the chain to be a co-signatory would strengthen the requirements. It is not clear whether this will be advantageous or lead to unnecessary delays in the system. On the whole, this could prove too cumbersome.

Referring to Question 9, a requirement to seek independent professional advice before certain financial transactions are undertaken would do little to improve security. A fraudulent act could still occur having taken such advice. Such a requirement could be unnecessary. The overall constraint on trustees is a statutory duty of care in any event.

Colin Richardson

Chairman, Investment Committee of the ACA

On behalf of the Association of Consulting Actuaries