ASSOCIATION OF
aca
CONSULTING ACTUARIES

Regis House, 45 King William Street, London EC4R9AN
Tel: +44 (0)20 3102 6761 Fax: +44 (0)20 3102 6766 EMail: acahelp@aca.org.uk
Web: www.aca.org.uk

24 January 2014

Folarin Akinbami,
Law Commission,
1st Floor, Tower, 52 Queen Anne's Gate,
London SW1H 9AG.

Email:fiduciary.duties@lawcommission.gsi.gov.uk

Dear Mr Akinbami

ACA RESPONSE TO LAW COMMISSION CONSULTATION PAPER No. 215:FIDUCIARYDUTIES OF INVESTMENT INTERMEDIARIES

I am writing on behalf of the **Association of Consulting Actuaries (ACA)**, in response to your consultation on the above.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given by members is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

The ACA is the representative body of consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

On the investment front, many of our members are asked to advise on scheme investment objectives and on asset allocation strategies appropriate to these objectives, taking into account each particular scheme's liabilities.

We welcome the opportunity to respond to the consultation. We have responded to the specific questions in the consultation paper below.

Yours sincerely

Hemal Popat
Chairman, ACA Investment Committee

ASSOCIATION OF CONSULTING ACTUARIES' (ACA) RESPONSE TO FIDUCIARY DUTIES OF INVESTMENTINTERMEDIARIES CONSULTATION

PENSION TRUSTEES' DUTIES TO ACT IN THE BEST INTERESTS OF BENEFICIARIES

Question 1:Do consultees agree that Chapter 10 of the Consultation Paper represents a correct statement of the current law? (14.6)

Other - As non-lawyers we are not able to comment on the correctness or otherwise of the statement, however the summary given is broadly consistent with the views our trustee clients (both DB and DC) have been given by their legal advisers. We note that an increasing proportion of pension investments are managed via contract-based arrangements, with no trustee oversight role.

Additionally, our view is that the primary purpose of pension fund trustees' investment powers should be to ensure that contributions are invested to provide the promised pensions in the future, and that other purposes are valid but should be subsidiary to this principle. To the extent the law is inconsistent with this, there is potential for undesirable outcomes, which may lead to lower public confidence in trust-based arrangements.

Question 2:Do consultees agree that the law reflects an appropriate understanding of beneficiaries' best interests? (14.11)

Other - We are not in a position to comment on this.

Question 3:Do consultees think that the law is sufficiently certain? (14.15)

Other - We are not in a position to comment on legal certainty.

In our view, stability of the underlying requirements over long periods is generally desirable, so as to avoid pension fund trustees needing to revisit existing investment decisions which may lead to transaction costs being incurred, ultimately by beneficiaries and/or their employers, in the event of portfolio changes.

Question 4:Should the Occupational Pension Scheme (Investment) Regulations 2005 be extended to all trust-based pension schemes? (14.15)

Other - We see little overall benefit in entirely removing the exemptions within the 2005 Regulations that apply to schemes with fewer than 100 members, or certain public sector schemes.There may be a case for reviewing the extent of the exemptions to ensure greater consistency of good practice, although the ultimate requirements should be proportionate to the value of assets held in trust to meet future pension payments. As such the public sector scheme exemptions seem anomalous, except where they have fewer than 100 members.

Our members' experience is that in many cases smaller schemes will already be compliant with many of the requirements of the regulations, particularly where trustees perceive this to be good practice and proportionate to their situation. We are mindful that many smaller trust-based schemes have closed in recent years and poorer economies of scale than larger schemes, or indeed contract-based arrangements, are almost certainly a factor in this trend.

Question 5:Are there any specific areas where the law would benefit from statutory clarification? (14.15)

No

Question 6:Do consultees agree that the law permits a sufficient diversity of strategies? (14.21)

Yes - In our view the law itself is not a barrier to trustees investing in a manner that is different to the pension fund consensus, provided that such investment is consistent with beneficiaries' best interests and other subsidiary objectives.

To the extent that pension fund trustees are unwilling to deviate from the consensus there are a number of causal factors, ranging from human behaviour ("herding instincts") to the actions of their agents, advisers and regulators.

Question 7:Do consultees agree that the main pressures toward short-termism are not caused by the duty to invest in beneficiaries' best interests? (14.24)

Yes - Our view is that the law does not encourage or discourage short-termism. This seems appropriate, given that short-termist behaviour may from time to time be consistent with beneficiaries' best interests. To the extent the legal framework is stable over time, this is likely to encourage a longer-term mindset, as trustees will have greater confidence that a long-term investment decision will not be impacted by regulatory changes during the lifetime of an investment (which can be 20 years or longer).

Trust-based pension funds (particularly DB) have greater scope than many investors to participate in longer-term investments, and thereby benefit where such investments are attractive from a risk and return perspective. The law does not appear to constrain this in our view, and indeed many pension funds have entered into new asset classes over the past few years as banks have scaled back their participation in long-term investment due to their own regulatory environment changing.

Question 8:Do consultees agree that the law is right to allow trustees to consider ethical issues only in limited circumstances? (14.28)

Yes - Our view is that the law strikes an appropriate balance between competing priorities, and that it is consistent with a pension fund's mission of existing to pay pensions.

Question 9:Does the law encourage excessive diversification? (14.32)

No - Diversification is necessary when investing due to the fact that there is asymmetric information between an investor and investee. An investor will have inferior (lower quality and less timely) knowledge about a company or investment than the issuer of a security. Hence unnecessary concentration is likely to result in excessive idiosyncratic risk, which can only be mitigated through extensive and costly due diligence, assuming an investor is given sufficient access to a company.

It is appropriate that the law should require trustees to consider such risks when determining their chosen investment strategy. Therefore in our view the law does not encourage excessive diversification.

Diversification does not prevent trustees appointing agents on their behalf who, aggregating across their investor base, have the ability to engage in constructive dialogue with companies on various matters.

Question 10:Does the law encourage trustees to achieve the right balance of risk and return? (14.32)

Yes - In our view the law, rightly, requires trustees to reflect in their investment strategy that a pension fund's primary objective is to pay pensions. This necessarily requires trustees to consider both their expectation of return on an investment or portfolio of investments, and the risk of gains or losses relative to this expectation. We consider this assessment to be a necessary but not sufficient step in determining the suitability of an investment for the pension fund.

Question 11:Are there any systemic areas of trustees' investment strategies which pose undue risks? (14.32)

No - In recent years, many DB pension funds have closed to new members and some have closed to future accrual. This has led many to adopt sophisticated risk management techniques (such as interest rate or inflation hedging using gilts or swaps) in recognition of their shortened time horizon and the consequently reduced risk appetite.

We are supportive of these techniques, provided they are appropriately implemented, as they are intended to increase the likelihood of fund members receiving their pensions in full. Many of our organisation's membership are practitioners in this area, helping pension fund trustees implement and monitor their fund's risk management and investment strategy.

Question 12:Overall, do consultees think that the legal obligations on trustees are conducive to investment strategies in the best interests of the ultimate beneficiaries? (14.33)

Yes - As noted in responses to previous questions our view is that the current legal framework for pension fund trustees is appropriate and consistent with a pension fund's purpose of existing to pay beneficiaries their pensions.

Question 13:If not, what specifically needs to be changed? (14.33)

No comment.

FIDUCIARY-TYPE DUTIES IN CONTRACT-BASED PENSION SCHEMES

Question 14:Do consultees agree that the duties on contract-based pension providers to act in the interests of scheme members should be clarified and strengthened? (14.42)

Yes - We are supportive of such legislative changes as they would ensure greater consistency of approach between contract-based and trust-based pension schemes, and improve the likelihood of contract-based schemes delivering high quality pensions.

There are transitional issues that will need to be considered, and it may not be straightforward to apply new requirements to existing contracts on a mandatory basis. Our expectation is that major providers would be incentivised from a branding perspective to make best endeavours to apply any new requirements to existing contracts.

Question 15:Should specific duties be placed on pension providers to review the suitability of investment strategies over time? If so, how often should these reviews take place? (14.42)

Yes - Our view is that the structure of default investment strategies should be subject to a comprehensive review at least every 5 years. We would expect providers to review other aspects, such as underlying investment manager appointments, on an ongoing basis as part of their duties.

Question 16:Should members of Independent Governance Committees be subject to explicit legal duties to act in the interests of scheme members? (14.42)

Yes - Assuming the concept of an Independent Governance Committee is hard-coded into legislation as a requirement of offering workplace pensions, it would be logical to make the legal duties explicit. If Independent Governance Committees are a voluntary undertaking or simply a method of ensuring compliance with any new statutory requirements, it would seem disproportionate to subject them to further statutory requirements.

Question 17: Should pension providers be obliged to indemnify members of Independent Governance Committees for liabilities incurred in the course of their duties? (14.42)

Yes - We consider it appropriate for providers to provide such an indemnity, since Independent Governance Committees will only have advisory powers and not executive powers over the underlying pension arrangements. It is also unlikely that Independent Governance Committees would have sufficient capital to compensate beneficiaries for any losses they might incur through factors such as poor investment performance, excessive fees or suboptimal investment strategy.

FIDUCIARY DUTIES IN THE REST OF THE INVESTMENT CHAIN

Question 18:Do consultees agree that the general law of fiduciary duties should not be reformed by statute? (14.61)

Yes - We would have concerns about new legislation being introduced that would impact other types of investors, whose aims are quite different to those of pension schemes.

Question 19:Should rights to sue for breach of statutory duty under section 138D of the Financial Services and Markets Act 2000 be extended? (14.67)

No - Whilst such extension appears worthy, we would question the extent to which such extension of rights is likely to result in improved outcomes for beneficiaries of pension schemes. Our view is that the increased litigation risks, and consequential costs, will lead to higher costs being passed down the investment chain, and ultimately to the detriment of beneficiaries.

Question 20:Is there a need to review the regulation of investment consultants? (14.71)

Yes - Asset allocation decisions have been found to account for a significant proportion of investment returns, over and above manager or fund selection. It is therefore difficult to justify the focus of current regulation where advice on pooled funds is regulated and advice on segregated or directly held investments is considered to be generic advice.

Bringing investment consultancy under the FCA regime could aid in providing a more structured advice and general standard of professionalism framework amongst consultancies. However, in our view imposing additional regulatory requirements on investment consultants is likely to increase the costs to schemes of receiving investment advice on generic matters and this should not be discounted. In particular we would caution against creating a statutory role in this area, and believe that this would create a barrier to entry to the investment consulting sector. We note that there are several examples in the last few years of new consultants being set up in the UK market and successfully competing with their larger competitors and building respected businesses in this area.

Question 21:Is there a need to review the law of intermediated shareholdings? (14.74)

Other - We have no comments on this question.

Question 22:Should the FCA review the regulation of stock lending by custodians? (14.75)

Other - We would be in favour of mandatory disclosure of stock lending income, although not necessarily fully rebated as this is a contractual matter between the investor and their agents.

Our experience is that custodians are generally disclosing income received through stock lending to pension fund trustees. It is not clear that it is commercially viable for all income to be rebated to investors, and such an approach could lead to situations where the costs of managing a stock lending programme (which entails risk) are lower than the income received.

Do you have any other comments about fiduciary duties in the investment chain, or how those duties are applied in practice?

No further comments.

Response by:

Association of Consulting Actuaries
Regis House, 45 King William Street, London EC4R 9AN
020 3102 6761 Web: www.aca.org.uk Email: acahelp@aca.org.uk

Contact for response: Hemal Popat
Hemal.Popat@towerswatson.com

ASSOCIATION OF
aca
CONSULTING ACTUARIES

Regis House, 45 King William Street, London EC4R9AN
Tel: +44 (0)20 3102 6761 Fax: +44 (0)20 3102 6766 EMail: acahelp@aca.org.uk
Web: www.aca.org.uk

24 January 2014

Folarin Akinbami,
Law Commission,
1st Floor, Tower, 52 Queen Anne's Gate,
London SW1H 9AG.

Email:fiduciary.duties@lawcommission.gsi.gov.uk

Dear Mr Akinbami

ACA RESPONSE TO LAW COMMISSION CONSULTATION PAPER No. 215:FIDUCIARYDUTIES OF INVESTMENT INTERMEDIARIES

I am writing on behalf of the **Association of Consulting Actuaries (ACA)**, in response to your consultation on the above.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given by members is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

The ACA is the representative body of consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

On the investment front, many of our members are asked to advise on scheme investment objectives and on asset allocation strategies appropriate to these objectives, taking into account each particular scheme's liabilities.

We welcome the opportunity to respond to the consultation. We have responded to the specific questions in the consultation paper below.

Yours sincerely

Hemal Popat
Chairman, ACA Investment Committee

ASSOCIATION OF CONSULTING ACTUARIES' (ACA) RESPONSE TO FIDUCIARY DUTIES OF INVESTMENTINTERMEDIARIES CONSULTATION

PENSION TRUSTEES' DUTIES TO ACT IN THE BEST INTERESTS OF BENEFICIARIES

Question 1:Do consultees agree that Chapter 10 of the Consultation Paper represents a correct statement of the current law? (14.6)

Other - As non-lawyers we are not able to comment on the correctness or otherwise of the statement, however the summary given is broadly consistent with the views our trustee clients (both DB and DC) have been given by their legal advisers. We note that an increasing proportion of pension investments are managed via contract-based arrangements, with no trustee oversight role.

Additionally, our view is that the primary purpose of pension fund trustees' investment powers should be to ensure that contributions are invested to provide the promised pensions in the future, and that other purposes are valid but should be subsidiary to this principle. To the extent the law is inconsistent with this, there is potential for undesirable outcomes, which may lead to lower public confidence in trust-based arrangements.

Question 2:Do consultees agree that the law reflects an appropriate understanding of beneficiaries' best interests? (14.11)

Other - We are not in a position to comment on this.

Question 3:Do consultees think that the law is sufficiently certain? (14.15)

Other - We are not in a position to comment on legal certainty.

In our view, stability of the underlying requirements over long periods is generally desirable, so as to avoid pension fund trustees needing to revisit existing investment decisions which may lead to transaction costs being incurred, ultimately by beneficiaries and/or their employers, in the event of portfolio changes.

Question 4:Should the Occupational Pension Scheme (Investment) Regulations 2005 be extended to all trust-based pension schemes? (14.15)

Other - We see little overall benefit in entirely removing the exemptions within the 2005 Regulations that apply to schemes with fewer than 100 members, or certain public sector schemes.There may be a case for reviewing the extent of the exemptions to ensure greater consistency of good practice, although the ultimate requirements should be proportionate to the value of assets held in trust to meet future pension payments. As such the public sector scheme exemptions seem anomalous, except where they have fewer than 100 members.

Our members' experience is that in many cases smaller schemes will already be compliant with many of the requirements of the regulations, particularly where trustees perceive this to be good practice and proportionate to their situation. We are mindful that many smaller trust-based schemes have closed in recent years and poorer economies of scale than larger schemes, or indeed contract-based arrangements, are almost certainly a factor in this trend.

Question 5:Are there any specific areas where the law would benefit from statutory clarification? (14.15)

No

Question 6:Do consultees agree that the law permits a sufficient diversity of strategies? (14.21)

Yes - In our view the law itself is not a barrier to trustees investing in a manner that is different to the pension fund consensus, provided that such investment is consistent with beneficiaries' best interests and other subsidiary objectives.

To the extent that pension fund trustees are unwilling to deviate from the consensus there are a number of causal factors, ranging from human behaviour ("herding instincts") to the actions of their agents, advisers and regulators.

Question 7:Do consultees agree that the main pressures toward short-termism are not caused by the duty to invest in beneficiaries' best interests? (14.24)

Yes - Our view is that the law does not encourage or discourage short-termism. This seems appropriate, given that short-termist behaviour may from time to time be consistent with beneficiaries' best interests. To the extent the legal framework is stable over time, this is likely to encourage a longer-term mindset, as trustees will have greater confidence that a long-term investment decision will not be impacted by regulatory changes during the lifetime of an investment (which can be 20 years or longer).

Trust-based pension funds (particularly DB) have greater scope than many investors to participate in longer-term investments, and thereby benefit where such investments are attractive from a risk and return perspective. The law does not appear to constrain this in our view, and indeed many pension funds have entered into new asset classes over the past few years as banks have scaled back their participation in long-term investment due to their own regulatory environment changing.

Question 8:Do consultees agree that the law is right to allow trustees to consider ethical issues only in limited circumstances? (14.28)

Yes - Our view is that the law strikes an appropriate balance between competing priorities, and that it is consistent with a pension fund's mission of existing to pay pensions.

Question 9:Does the law encourage excessive diversification? (14.32)

No - Diversification is necessary when investing due to the fact that there is asymmetric information between an investor and investee. An investor will have inferior (lower quality and less timely) knowledge about a company or investment than the issuer of a security. Hence unnecessary concentration is likely to result in excessive idiosyncratic risk, which can only be mitigated through extensive and costly due diligence, assuming an investor is given sufficient access to a company.

It is appropriate that the law should require trustees to consider such risks when determining their chosen investment strategy. Therefore in our view the law does not encourage excessive diversification.

Diversification does not prevent trustees appointing agents on their behalf who, aggregating across their investor base, have the ability to engage in constructive dialogue with companies on various matters.

Question 10:Does the law encourage trustees to achieve the right balance of risk and return? (14.32)

Yes - In our view the law, rightly, requires trustees to reflect in their investment strategy that a pension fund's primary objective is to pay pensions. This necessarily requires trustees to consider both their expectation of return on an investment or portfolio of investments, and the risk of gains or losses relative to this expectation. We consider this assessment to be a necessary but not sufficient step in determining the suitability of an investment for the pension fund.

Question 11:Are there any systemic areas of trustees' investment strategies which pose undue risks? (14.32)

No - In recent years, many DB pension funds have closed to new members and some have closed to future accrual. This has led many to adopt sophisticated risk management techniques (such as interest rate or inflation hedging using gilts or swaps) in recognition of their shortened time horizon and the consequently reduced risk appetite.

We are supportive of these techniques, provided they are appropriately implemented, as they are intended to increase the likelihood of fund members receiving their pensions in full. Many of our organisation's membership are practitioners in this area, helping pension fund trustees implement and monitor their fund's risk management and investment strategy.

Question 12:Overall, do consultees think that the legal obligations on trustees are conducive to investment strategies in the best interests of the ultimate beneficiaries? (14.33)

Yes - As noted in responses to previous questions our view is that the current legal framework for pension fund trustees is appropriate and consistent with a pension fund's purpose of existing to pay beneficiaries their pensions.

Question 13:If not, what specifically needs to be changed? (14.33)

No comment.

FIDUCIARY-TYPE DUTIES IN CONTRACT-BASED PENSION SCHEMES

Question 14:Do consultees agree that the duties on contract-based pension providers to act in the interests of scheme members should be clarified and strengthened? (14.42)

Yes - We are supportive of such legislative changes as they would ensure greater consistency of approach between contract-based and trust-based pension schemes, and improve the likelihood of contract-based schemes delivering high quality pensions.

There are transitional issues that will need to be considered, and it may not be straightforward to apply new requirements to existing contracts on a mandatory basis. Our expectation is that major providers would be incentivised from a branding perspective to make best endeavours to apply any new requirements to existing contracts.

Question 15:Should specific duties be placed on pension providers to review the suitability of investment strategies over time? If so, how often should these reviews take place? (14.42)

Yes - Our view is that the structure of default investment strategies should be subject to a comprehensive review at least every 5 years. We would expect providers to review other aspects, such as underlying investment manager appointments, on an ongoing basis as part of their duties.

Question 16:Should members of Independent Governance Committees be subject to explicit legal duties to act in the interests of scheme members? (14.42)

Yes - Assuming the concept of an Independent Governance Committee is hard-coded into legislation as a requirement of offering workplace pensions, it would be logical to make the legal duties explicit. If Independent Governance Committees are a voluntary undertaking or simply a method of ensuring compliance with any new statutory requirements, it would seem disproportionate to subject them to further statutory requirements.

Question 17: Should pension providers be obliged to indemnify members of Independent Governance Committees for liabilities incurred in the course of their duties? (14.42)

Yes - We consider it appropriate for providers to provide such an indemnity, since Independent Governance Committees will only have advisory powers and not executive powers over the underlying pension arrangements. It is also unlikely that Independent Governance Committees would have sufficient capital to compensate beneficiaries for any losses they might incur through factors such as poor investment performance, excessive fees or suboptimal investment strategy.

FIDUCIARY DUTIES IN THE REST OF THE INVESTMENT CHAIN

Question 18:Do consultees agree that the general law of fiduciary duties should not be reformed by statute? (14.61)

Yes - We would have concerns about new legislation being introduced that would impact other types of investors, whose aims are quite different to those of pension schemes.

Question 19:Should rights to sue for breach of statutory duty under section 138D of the Financial Services and Markets Act 2000 be extended? (14.67)

No - Whilst such extension appears worthy, we would question the extent to which such extension of rights is likely to result in improved outcomes for beneficiaries of pension schemes. Our view is that the increased litigation risks, and consequential costs, will lead to higher costs being passed down the investment chain, and ultimately to the detriment of beneficiaries.

Question 20:Is there a need to review the regulation of investment consultants? (14.71)

Yes - Asset allocation decisions have been found to account for a significant proportion of investment returns, over and above manager or fund selection. It is therefore difficult to justify the focus of current regulation where advice on pooled funds is regulated and advice on segregated or directly held investments is considered to be generic advice.

Bringing investment consultancy under the FCA regime could aid in providing a more structured advice and general standard of professionalism framework amongst consultancies. However, in our view imposing additional regulatory requirements on investment consultants is likely to increase the costs to schemes of receiving investment advice on generic matters and this should not be discounted. In particular we would caution against creating a statutory role in this area, and believe that this would create a barrier to entry to the investment consulting sector. We note that there are several examples in the last few years of new consultants being set up in the UK market and successfully competing with their larger competitors and building respected businesses in this area.

Question 21:Is there a need to review the law of intermediated shareholdings? (14.74)

Other - We have no comments on this question.

Question 22:Should the FCA review the regulation of stock lending by custodians? (14.75)

Other - We would be in favour of mandatory disclosure of stock lending income, although not necessarily fully rebated as this is a contractual matter between the investor and their agents.

Our experience is that custodians are generally disclosing income received through stock lending to pension fund trustees. It is not clear that it is commercially viable for all income to be rebated to investors, and such an approach could lead to situations where the costs of managing a stock lending programme (which entails risk) are lower than the income received.

Do you have any other comments about fiduciary duties in the investment chain, or how those duties are applied in practice?

No further comments.

Response by:

Association of Consulting Actuaries
Regis House, 45 King William Street, London EC4R 9AN
020 3102 6761 Web: www.aca.org.uk Email: acahelp@aca.org.uk

Contact for response: Hemal Popat
Hemal.Popat@towerswatson.com