Competition & Markets Authority

Background

I write as a professional independent pension scheme trustee. I look after defined benefit (DB) pension liabilities of approximately £5bn. This covers two public sector pension schemes (one unfunded) and over a dozen private sector pension schemes ranging in size from £1.5m to £800m; one has had fiduciary management in place since 2007. In a few cases my company is the sole trustee. I am also an actuary undertaking occasional advisory and expert witness work. I was a practicing Scheme Actuary until 2010. I am not authorised to give investment advice. Last century I had only passing involvement in placing insurance business and investments via an actuarial consultancy regulated by the Institute of Actuaries. I have no material involvement with, or comments on, defined contribution (DC) pensions or Master Trusts.

General Comments

Prior to tackling your specific challenges, commenting on your hypotheses and potential remedies may I mention the following?

1. As you mention, Paul Myners, now Lord Myners, undertook a comprehensive review of the DB occupational pension scheme investment world in 2001. The emerging **Myners Principles** were reviewed by H M Treasury and the Department for Work and Pensions in 2003. I suggest the comprehensive emerging DWP Research Reports #195 & 213 would also be well worth considering.

2. DB schemes in the UK can be divided into two categories, those with interest rate and inflation protection in place and those without. Liability driven investment (**LDI**) is arguably a bigger issue for DB pension schemes than investment advice, investment management and asset performance. I suggest your study is widened to incorporate the crucial access to, critical mass required and necessary funding margins for, LDI.

3. Funded **public sector** pension schemes, local government pension schemes in particular, provide several aspects of operation and governance that are relevant. I suggest specific attention to the success of their moves to in-house asset management, compulsory competitive tendering, fee negotiations with investment managers and framework of investment consultant input.

4. DB schemes have triennial actuarial funding valuations. Annual valuations are undertaken for most sponsor accounting requirements. Approximate continuous monitoring of funding is available via most of the major actuarial consultancies. I suggest the statutory involvement of the **Scheme Actuary** could be usefully extended to provide independent comment on asset allocation, funding risk and return. The actuarial profession is committed to acting in the public interest.

5. Chairs of DC pension schemes are required to provide a **Statement** in the Annual Report & Accounts. I suggest extending this requirement to DB schemes to cover investment, funding, covenant and governance aspects. Such DB Chair Statements need cover no more than the material underlying the Pensions Regulator's (TPR) integrated risk management (IRM) initiative but would provide a practical additional reporting area for investment consultancy, management and conflict of interest disclosure.

6. I suggest recognition of the practical constraints facing schemes of different **size -** large, medium and small schemes, perhaps defined via the existing 100 and 5,000 member differentiations.

7. And finally; Although not relevant to funded DB pensions, I feel obliged to mention the burden placed on future tax payers by £1.6tn of <u>un</u>funded public sector pension promises. The underlying SCAPE discount rate of CPI+2.8% per annum totally dwarfs the significance of funded DB investment costs, controls and governance. Even the most efficient investment industry isn't going to generate that GDP growth.

Specific points and questions

For ease of reference the Market Investigation Statement paper paragraph numbers are referred to –

- Para 7; See above.

- Para 10; 12th October - a longer period would have been appreciated.
- Para 12; The legislative requirements (Pensions Act 1995 S32-39) for trustees to take authorised investment advice etc. shouldn't be underestimated. That said additional legislation to definitively separate investment consultancy from investment management should be considered.
- Para 14; Alternative (to the above) legal definition and separation of investment consultancy and investment management should be considered. I think that rejection of the UIL was appropriate.
- Para 15; Size is important. The Pensions Regulator has said (off the record) that around 2,000 DB schemes lack appropriate governance, this undoubtedly extends to investment knowledge and understanding. Whilst I don't think DB consolidation is feasible, some compulsion around investment advice and review would be justified, but only for larger schemes (5,000 members+). The Scheme Actuary may however be well placed to assist for small and medium sized schemes.
- Para 20; Just a reminder that Lord Myners suggested a division between (Scheme) actuarial and investment advice. I think this could be made compulsory for large schemes, most will already be split. For medium sized scheme recommended practice and disclosure may suffice. For smaller schemes one stop shopping is common, practical and sufficient.
- Para 22; I think any effects would be minimal.
- Para 34; The Review of the Myners Principles should be considered.
- Para 38; Some order or priority might usefully be added by the FCA and CMA. LDI and asset allocation (matching liabilities) is far more important than manager selection and consequential management and monitoring.
- Para 40; I suggest outcomes include considerations around funding, matching, risk and LDI. (IRM!)
- Para 50; For large schemes, I suggest compulsory competitive tendering every 3-4 years. If it is appropriate for public sector governance and audit then why not investment. Public sector procurement rules could be very easily copied. For medium sized schemes FCA recommendation and disclosure may suffice. For small schemes I just suggest relying of TPR IRM scrutiny.
- Para 52; Consultation on the Statement of Investment Principles (PA S35) should guarantee sufficient employer input but explicit additional requirements/involvement might be considered albeit employer covenant and PPF considerations will be relevant.
- Para 57; For small and medium sized schemes, the Scheme Actuary could also be invited to formally comment and/or the Chair of Trustees could be required to include relevant detail in an Annual Chair's Statement.
- Para 60; "Which index, and over which carefully chosen period, have you outperformed this time?" should become a standard investment manager challenge.
- Para 64+; The industry conflicts of interest are dreadful. Whether actual, perceived or just potential a clear ownership, operational and disclosure division is necessary. "Trust" shouldn't have to be a feature.
- Para 89; I suggest the UIL provides tangible evidence that FSA action is required.
- Para 96; Information is available but independent advice may be expensive and difficult to get.
- Para 98; Clear and consistent information in relation to all fees would indeed be nice.
- Para 99; Consistent reporting of fees charged compared to those quoted or estimated shouldn't be an issue.

- Para 100; Requiring investment consultants to report all fees to an independent benchmarking service to allow pension schemes and employers to compare their fees to the market doesn't seem practical.

- Para 101; Requiring investment consultants, when providing advice, to be clearer on the impact of a particular course of action on their own fees again seems impractical. Only standard caveats and small print would emerge.

- Para 102; Banning certain (current) investment consultant pricing practices would just lead to alternatives being developed.

- Para 103; Requiring investment consultants to report on pension fund returns against agreed benchmarks would help but any decent consultant could easily tweak the remit to make most published indices inappropriate.

- Para 104; Requiring investment consultants to report the fees of asset managers selected and give details on the extent to which they have reduced fees for the trustees shouldn't be new or difficult.

- Para 105; Requiring investment consultants to report the performance of their manager recommendations based on standardised performance metrics (see 103 above).

  I however suggest the FSA & CMA also look at investment platforms. These are a feature for small DB schemes as well as DC and discounts on direct manager fees are a common capturing and retaining feature.

- Para 106; Requiring pension schemes and employers to provide reviews of investment consultants, with aggregate results shared/available on websites would only be appropriate for large schemes.

- Para 107; Introducing mandatory tendering for consulting, fiduciary management services and/or master trusts. Yes, but for large schemes only.

- Para 108; Establishing rules to improve the tendering process would help, see public procurement comment above.

- Para 109; Produce standardised off-the-shelf tender documents that smaller pension schemes and employers could (but would not be obliged to) use to make tendering cheaper, easier and more effective – good idea.

- Para 110 & 111; Aggregation and consolidation of pension trusts – I don't think this is feasible (too many legal considerations and no government will round down) but new products from providers, e.g. Legal & General LDI would help. The PPF consolidates schemes very well but I suggest no one else can.

- Para 113; Requiring the inclusion of at least one professional trustee for each pension scheme/enhance training for trustees – good idea and vested interest immediately declared.

- Para 116 & afterwards; The conflict of interest and hospitality have to be declared and independent advice sought. Compulsory tendering (large schemes) and trustee disclosure of any management contracts entered into without independent advice seems appropriate.

I would be delighted to expand on any aspect of the above.

Allan C Martin