



The Actuarial Profession

making financial sense of the future

consultation response

**HM Treasury Report:
Myners principles for institutional investment
decision-making: review of progress**

Response from the Actuarial Profession

March 2005



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Paul Myners
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

16 March 2005

Please reply to: Staple Inn

Dear Paul,

Meeting to discuss proposed changes to the Myners principles

We are pleased to enclose the response of The Actuarial Profession to the *Myners principles for institutional investment decision-making: review of progress*. As you will see, we have focussed our comments primarily upon the proposed changes to the principles rather than the original principles themselves.

Actuaries are deeply involved in the issues of asset/liability matching and asset allocation. We would, therefore, value an early discussion with you to clarify our thinking as we adapt to take account of the proposed procedures. We believe that it is right to adapt the principles, but believe that there may need to be some further amendment to cover some practicalities.

Yours sincerely

Gordon Bagot



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MYNERS PRINCIPLES FOR INSTITUTIONAL INVESTMENT DECISION-MAKING: REVIEW OF PROGRESS

The Actuarial Profession's perspective

The work of The Actuarial Profession is closely connected with the current investment system. The Profession's membership represents all the steps in the pension fund investment chain including: finance directors of companies sponsoring pension schemes, pension fund trustees, scheme actuaries, investment consultants, performance measurers, fund managers, analysts, bankers and back full circle to finance directors of corporates raising capital for their businesses. Our members are also involved in the insurance industry where tailor-made investment strategies to suit their particular product and solvency issues are more common.

As an independent professional body, we are able to stand back and look across the links in the investment system. We are keen to improve the mechanisms for connecting these links so that corporates raising capital and products using these investment opportunities better reflect the demands of long-term investors with long-term liabilities. In the current environment, with pension funds and insurance companies facing lower levels of solvency, our understanding of the liability-related risks that they wish to manage will be key in devising new solutions to help better manage these risks through asset allocation.

Following the publication of the proposed revisions to the Myners principles by HM Government, submissions have been requested by March 16th.

This note represents a response by The Actuarial Profession focusing primarily on the proposed changes to the principles rather than the original principles themselves. Bearing in mind how influential the Profession's members are in the successful implementation of the principles, we would value an opportunity to meet with Mr Myners and his team to discuss the matters under review.

Proposed revisions

1. Effective decision-making

The proposed changes are designed to give greater clarity to what is expected in the area of investment expertise by Trustees, both as Trustees, and, for larger schemes, in respect of in-house advice.

In general, we support these proposals, accepting that it is going to take time to achieve the required level of investment expertise. It is also worth saying that what are required are both investment expertise and an understanding of the interplay of assets and liabilities – a point which becomes important in some of the other principles.

It might also be sensible for several schemes to 'share' in-house investment expertise; four people providing a service to four large schemes might be more effective than one per scheme and should be seen as a viable alternative. Such shared expertise would

need to be independent of any other advice taken by the Trustees. It could tie in with expertise on asset allocation covered in later points.

2. Clear objectives

We support the concept of clear objectives for pension funds; this needs to include risks in asset/liability matching and mismatching. We are glad to note that Mr Myners is recommending objectives which are scheme specific.

3. and 4. Asset allocation and Expert advice

In essence, the recommendation stresses the importance of asset allocation and recommends that there be a separate contract for it.

We believe that Mr Myners has correctly identified a problem in the process of managing pension funds. However, we think that there are some broad issues in asset allocation which need to be considered:

- 3.1 The value of the liabilities needs to be clearly established – and their basis which is different for different scenarios, such as wind-up, accounting etc.
- 3.2 The degrees of risk which the scheme – and its sponsor and members – can take need to be considered and defined
- 3.3 From (1) and (2) a portfolio can be designed which minimizes the risk of default. The Trustees also need to establish how far from this they can depart within acceptable risk - in essence, what is their risk budget.
- 3.4 A process needs to be established for dynamically adapting the allocation to different asset classes, as both assets and liabilities change.
- 3.5 Fund managers need to be involved in these processes so that they can suggest adaptation and can manage to appropriate mandates.

There is more than one way of forming a logical process to encompass the above steps; what is important is that the managers of both the liabilities (presumably the scheme actuaries) and the managers of the assets (presumably the chosen fund managers) work together with the Trustees to make sure that all steps are covered and all expertise is brought to the table.

Mr Myners suggests that the way to resolve the underlying problem is to have a separate contract for an asset allocation specialist. This is one solution; what we believe is important is that:

- A. There are people involved with a good understanding of all issues involved – particularly managing assets, liabilities and their interplay.
- B. There is good communication amongst those involved, together with the Trustees.

There is a shortage of people with practical experience of (A) and (B) above. It would make sense to develop more training in these areas. There is no doubt that too little emphasis has been given to asset allocation, both strategic and tactical. To correct this we believe that each scheme should seek to:

- (i) Ensure that they have access to one or more people who are capable of acting as strategic managers of the total pension scheme (this would tie in with the first Myners recommendation above).

(ii) Ensure that they have a process in place to bring all expertise employed to a common table and common agenda.

(This process would draw together the broad issues involved in asset allocation.)

We also believe that there needs to be a major drive to train more expertise in asset allocation. Much of the training of actuaries is concerned with managing assets, liabilities and their interaction. The Actuarial Profession could expand its training to a wider audience so that there was a greater pool of expertise in the area of both asset allocation and asset/liability management.

5. Explicit mandates

The only proposed change to the Myners' principles here is to clarify what timescales are appropriate for performance consideration. The change is sensible.

6. – 10. Activism to Regular reporting

We have no comment to make on the proposed changes here which are again designed to ensure that objectives are clear and that there is good communication.