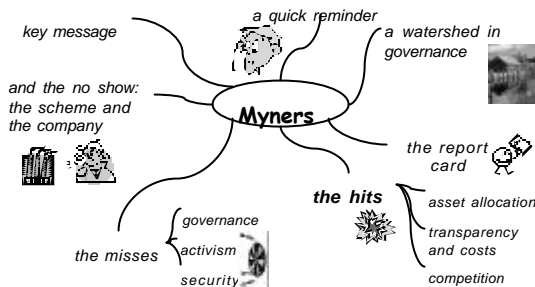


2003 Pensions Convention

Myners – Two Years On
Nick Watts

1 - 3 June
Grand Hotel, Brighton

Introduction



Myners : the original drivers

- Pension Funds were perceived not to be investing sufficiently in private equity
- Institutions were not being imaginative enough in their investment decision making to capture excess return

Myners : a quick reminder



- The goal
 - a blueprint for improving efficiency and flexibility
- Key themes addressed
 - Governance: a major limiting factor
 - Asset allocation: scheme specific
 - Competition: issues concerning consultants, managers, brokers
 - Regulation: transparency (external accountability); and security (MFR)
- Key development: self regulation through adoption of the new principles

Myners : a watershed in governance



- How important is Myners in the context of the pensions crisis?
- Was it well timed?
 - The timing was prophetic
 - The timing was unfortunate
- End of complacency or simply box ticking?

The 10 Myners principles

- Effective decision making
- Clear objectives
- Focus on asset allocation
- Expert advice
- Explicit mandates
- Activism
- Appropriate mandates
- Measuring performance
- Transparency statement
- Regular reporting

Sensible concepts: the devil is in the detail!

Myners: the report card (as graded by Watson Wyatt)



Subject	Remarks	Marks
Myners Principles	Completion very good, but box ticking more than engagement	8/10
Governance	Slow to develop and legislation has proved difficult	4/10
Focus on asset allocation	Moving in the right direction but still room for improvement	6/10
Transparency and costs	Room for improvement but Myners proposals unduly detailed	6/10
Security	MFR replacement slow and in current conditions it is difficult to achieve increased security with acceptable cost	3/10
Competition	Competition in consulting increased; little change elsewhere	5/10
Activism	Has put this on the agenda, but still awaiting HMV critical piece of work	3/10

Hits : more attention to asset allocation



- Focus on scheme-specific issues is a much better approach than the peer group approach
- Clear targeting of objectives based on liabilities
- The traditional model...
 - three year ALM cycle around the actuarial valuation
 - use of rebalancing to maintain the allocation
 ...has to move forwards
- A requirement to consider all asset classes

There is more focus on asset allocation but was Myners the driver?

Hits : transparency and costs



- Transparency – particularly relations between trustee, fund manager and brokers
- Total costs are now subject to more scrutiny
- More transparency is appropriate in terms of principal/agent relationship

In a low return environment, there is more focus on net return after all costs



Hits : competition in the consulting industry

- Very few entrants, but more competition in the market
- Appointment of investment consultants is often now considered separately from that of the actuarial adviser
- Key issues:
 - Lack of resource
 - Independence of advice
 - Accountability

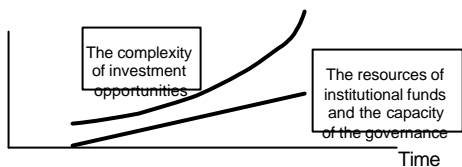
The consulting industry is changing rapidly but scale remains an issue



Misses : governance

Where are we now?

- Normal governance is having difficulty:
 - it's under-resourced, its over-extended...
 - funds are turning to different governance models





Misses : governance

Where are we now?

- Pension governance compared to corporate governance is challenging
- Trustee model is mainly amateur
- Investment world is becoming more complex
- Decisions required from trustees are more challenging
 - less surplus
 - lower expected returns
 - no 'rising tide to lift all boats'
- For example, the case for diversification into alternative assets is strong *but the governance capability is still weak*

This is a massively important industry but pension fund governance resources remain too low

Misses : governance



Clarity of trustee decision making and trustee skills

Watson Wyatt 2003 trustee survey – some highlights:

- Trustees rank
 - well-communicated investment advice
 - spending sufficient timeas the key elements of decision making effectiveness
- But*
- Trustees believe they have a significant training need
- Trustees doubt their ability to question their external advisers
- Trustees feel they spent insufficient time on key investment issues

Misses : governance



Familiarity

- Standard of care was 'objective reasonable test'
- New test requiring 'familiarity'... and, if not, they must delegate decision.
 - Applying to whom?
 - How defined?

Would you be a trustee?

Misses : governance



The role of consultants in the future

- To give more direction on strategy
- To integrate current valuation factors with the longer term time horizon (10 years or so)
- To integrate investment and actuarial considerations:
 - unique trust considerations
 - contingent options
 - stakeholder interests

Lots to do! Can the industry deliver?

Misses : activism



- Problem of principal or agent
- Lack of resource among fund management community currently: increased future cost to schemes?
- We question the level of take up of the ISC Statement of Principles

Momentum is behind this issue - the stick of legislation looms

Misses : activism



How can the pension industry achieve greater engagement - activism?

- Through individual fund pressure on managers 3%
- As in (1) plus collective manager co-operation 17%
- As in (1) but principally through longer term mandates 32%
- As in (2) but principally through longer term mandates 41%
- Through further government regulation 7%

Source: Watson Wyatt Valentines Day Seminar 2003

Misses : activism



Why will managers hold back from supporting engagement - activism initiatives?

- Stock holding periods are too short 11%
- These activities may reduce buying flexibility 13%
- The costs of these activities are significant 45%
- Managers will often have insufficient influence to make a difference because of their holding sizes 17%
- Trustee interference may conflict with positive action 14%

Source: Watson Wyatt Valentines Day Seminar 2003

Misses: security



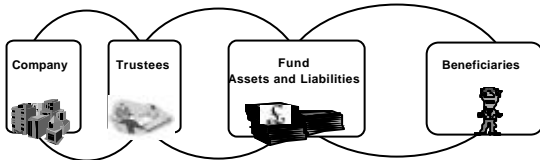
- Multiple measures
 - FRS 17
 - MFR
 - Discontinuous
 - Ongoing
- Short-term vs long-term
- Actuaries vs financial economists

Trustees need help here

...and the no show:
~~the scheme and the company~~



The DB pension fund mission:
The management of a fast moving balance sheet...
...in a deal between the *company* and *trustees*



...and the no show:
~~the scheme and the company~~



- Alignment of the sponsoring company with the scheme
 - FRS 17
 - Short-termism
- This point is receiving attention from industry but not as a result of Myners
- Covenant strength of company vital component in construction of the 'risk budget'
- The company must decide the amount of risk capital they are prepared to take in what is usually regarded as a 'non-core' activity
- How does the responsibility for asset allocation/risk taking between the company and trustees work?

Myners was almost silent on these key questions

How joined up and consistent has the government been?



Pensions Act

- Established model where trustees have stewardship and responsibility for asset allocation
- Wide responsibility breeds a risk averse, conservative approach

A risk management exercise

Myners

- Myners tells trustees to focus on asset allocation and directs trustees towards alternative assets
- *But* trustees remain overly cautious since they continue to carry the burden of full responsibility

A return seeking exercise

Myners : A 'rain check'



- The government needs to investigate whether current legislation is really realistic and involve the company sufficiently
- We need clarity on responsibilities and on consequences of decisions and actions by all the stakeholders
- The Pension Act states that ownership of asset allocation rests with trustees but in practice the picture is less clear
- There is review fatigue but we have not got close to settling this issue

Myners was important but other issues are more important

Summary

- The industry needs to change whether driven by government or other forces
- Innovation is critical to success and Myners has played a part
- More effective decision making from trustees:
 - Need to increase frequency of asset allocation reviews
 - Need to improve skills at trustee level
 - Need appropriately resourced investment sub-committees

Success will require more communication and more of a partnership from all the stakeholders

Questions
