

Myners consultation team
Room 3/20
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

23rd June 2008

Updating the Myners principles: a consultation - March 2008

The CFA Institute Centre for Financial Market Integrity ("CFA Institute Centre") welcomes the opportunity to comment on HM Treasury's consultation (the "Consultation") on updating the Myners Principles (the "Principles," including the original and proposed revisions).

Broadly, we welcome the proposals to produce an updated set of Principles for pension scheme trustees. As noted in the National Association of Pension Funds (NAPF) review in November 2007¹, the industry has undergone a number of changes since the original Myners report was published in 2001², with the shift from scheme surpluses to deficits, the increasing prominence of defined contribution ("DC") schemes, new legislation, and an increase in the range and complexity of investment products and investment strategies. Consequently, we concur that it is important that the Principles that underpin decision-making and governance are updated, so that trustees are better able to fulfil their fiduciary duties in the present environment; and so that scheme members' interests are better served.

Given the existing extensive legislative requirements placed on trustees, we believe that the most efficient method of improving trustee decision-making and governance would be to produce a more high-level set of voluntary Principles. This would avoid increasing the legal burden on trustees. To this extent, we welcome the emphasis on the revised Principles being less prescriptive. We also support the proposal to introduce best-practice guidance which should enable trustees to effectively implement the Principles. This guidance also serves as a basis for trustee assessment, an area noted by the NAPF review as being most in need of improvement.

The CFA Institute Centre strongly supports the inclusion of 'Trustee Tools' as set out in Annex C of the Consultation as a set of practical aids to help trustees fulfil their duties. The CFA Institute Centre has published its own code of conduct for pension trustees, known as the *Code of Conduct for Members of a Pension Scheme Governing Body* (the "Code")³. The Code comprises a set of 10 fundamental ethical responsibilities that are universally applicable to members of a pension's governing board, regardless of the type of pension scheme or where the scheme is formed or managed.

¹ National Association of Pension Funds, "Institutional Investment in the UK: six years on", November 2007

² Myners, P. "Institutional Investment in the United Kingdom: A Review", March 2001

³ See CFA Institute Centre for Financial Market Integrity, "Code of Conduct for Members of a Pension Scheme Governing Body", May 2008 at <http://www.cfapubs.org/toc/ccb/2008/2008/3>

We encourage the creation of the proposed Investment Governance Group (the “Group”) to “take ownership” of the Principles, through monitoring and oversight of their application. We advocate industry participation in this governing body; drawing membership from experts and industry professionals will maximise the effectiveness of the Group and ensure an alignment of interests between industry practitioners and the governing body.

In conjunction with the revised Principles, we support revisions to cover DC schemes, and recommend that much greater focus be placed on such schemes. As noted in the NAPF review, membership in DC schemes has increased from approximately 3 million at the time of the original Myners review to approximately 4 million today, with DC scheme growth expected to continue. For the Principles to remain relevant, it is important that they are not merely reactive but forward-looking. Consequently, the Group should take immediate steps to increase the prominence of DC schemes.

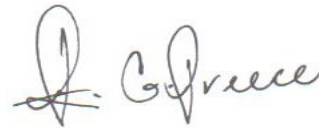
Finally, as the NAPF review also points out, levels of compliance with the Principles are lowest amongst small schemes. Given that trustees of small schemes often lack sufficient knowledge and understanding, and have relatively limited access to resources, it is clear that small schemes would benefit from help. We therefore feel it is appropriate that the Group help small schemes apply the Principles.

Yours faithfully,

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The CFA Institute Centre⁴ is part of CFA Institute⁵. With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of approximately 95,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries, of whom more than 81,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 countries and territories.

Our detailed comments follow the order of the Consultation's questions and are presented below.

Q1: *Will the proposed approach (comprising an updated set of principles, best practice guidance, trustee tools, better quality reporting and greater industry ownership of the principles) improve standards of investment decision-making and governance?*

The findings of the NAPF review indicate that there is room for improvement in the application of the Principles. This implies that, at an overall level, there is a need to update the current Principles and guidance to ensure optimal investment decision-making and governance.

We agree that the best way to improve standards of decision-making and governance is to introduce a more high-level set of voluntary Principles with associated best practice tools (such as The Pensions Regulator (TPR) Trustee Toolkit, TPR guidance, etc). This would enable trustees to have sufficient guidance to fulfil their fiduciary duties (whilst not enduring additional legislative burdens). Furthermore, better-quality reporting, together with greater industry participation in the oversight of the Principles, will improve levels of transparency and accountability, both of which are in the best interests of scheme participants and beneficiaries.

Q2: *Do you agree with:*

- *The proposed updated principles (as set out in full in Annex C)?*
- *The proposed best practice supporting guidance (as set out in full in Annex C)?*

The updated Principles proposed by HM Treasury are set out as presented in the Consultation.

⁴ The CFA Institute Centre develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct, Global Investment Performance Standards (“GIPS®”), and the Asset Manager Code of Professional Conduct (“AMC”). It represents the views of investment professionals and investors before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and the transparency and integrity of global financial markets.

⁵ CFA Institute is best known for developing and administering the Chartered Financial Analyst curriculum and examinations and issuing the CFA Charter.

Principle 1: Effective Decision-Making

Description: Trustees should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation. Trustees should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

We agree with the proposed updated Principle and associated best practice-supporting guidance. As the NAPF review highlights, industry participants believe this is the key Principle and remains central to effective governance. Consequently, the pertinence and utility of this Principle is supported by the significant increase in the levels of trustee knowledge and understanding since the original Myners review.

The proposed changes to the best practice guidance are broadly consistent with the CFA Institute Centre's Code. The Code focuses on trustees exercising an appropriate level of skill, knowledge and diligence, through Principle 3 which calls on trustees to "Act with skill, competence, and diligence." Guidance to this principle adds the following, (p.4-5):

"Prior to taking action on behalf of the scheme, effective trustees and/or their designees analyse the potential investment opportunities and act only after undertaking due diligence to ensure they have sufficient knowledge about specific investments or strategies...."

The guidance states further:

"Trustees are expected to take any training or educational opportunities necessary to ensure that their level of knowledge and understanding about pensions and investments remains current."

The best practice guidance set out in the Consultation proposes the creation of an investment sub-committee to provide the appropriate focus and skills for investment decision-making. However, we question the merit of proposing the creation of such a sub-committee. In practice, this may lead to an unnecessary and additional layer of supervision, and may result in duplicative efforts on behalf of the board. Instead, we recommend that this part of the guidance refer to the need to conduct appropriate *due diligence* in order to ensure that investment decisions have a reasonable basis. This is more effective guidance for trustees. Further, we would welcome reference to the usefulness of *training and education* for trustees. We note that the proposed guidance advocates that trustees have the appropriate skills, and have access to sufficient internal and external resources to make effective decisions. However, we believe that explicit reference to training and education in the best practice guidance would better serve trustees in effectively performing their fiduciary duties.

Principle 2: Clear Objectives

Description: Trustees should set out an overall investment objective(s) for the fund that takes account of the scheme's liabilities, the strength of the sponsor covenant as well as the attitude to risk of both the trustees and the sponsor, and clearly communicate these to advisers and investment managers.

Setting clear objectives remains a cornerstone of effective decision-making as it provides the basis for performance assessment (and is therefore necessary for the effectiveness of Principle 4 to be measurable). The linkage between the setting of objectives, and scheme liabilities and attitudes to risk, is welcome. This focuses attention on managing schemes relative to scheme-specific objectives, as opposed to more generic benchmarks which may be inappropriate in light of the willingness and ability of the scheme to take risks.

The focus on risk tolerances and liabilities in setting scheme objectives, along with guidance for establishing clear written mandates, is promoted by Principle 7 of our Code, "Take actions that are consistent with the established mission of the scheme and the policies that support that mission." The guidance to this principle calls on trustees to (P.7-8):

"Draft written policies that include a discussion of risk tolerances, return objectives, liquidity requirements, liabilities, tax considerations, and any legal, regulatory, or other unique circumstances."

and to:

"Establish policy frameworks within which to allocate risk for both asset mix policy risk and active risk as well as frameworks within which to monitor performance of the asset mix policies and the risk of the overall pension fund."

This implies that the level of risk determined by the range of asset classes should be monitored so that it is consistent with the specific risk tolerance of the scheme.

Accordingly, we are broadly supportive of the proposed best practice guidance to accompany this Principle. This guidance, as set out in the Consultation, focuses on benchmarks and scheme objectives, clear written mandates, appropriate consideration of range of asset classes, active versus passive management styles, and strength of the sponsor covenant.

Principle 3: Risks and Liabilities

Description: In setting and reviewing their investment strategy, trustees should take account of the form and structure of liabilities. These include the strength of the sponsor covenant, the risk of sponsor default and longevity risk.

We note that evidence gathered by the NAPF indicated that the Principle as originally drafted was overly prescriptive and placed insufficient focus on liabilities. We are supportive of the increased focus on risks and liabilities - particularly in light of the increase in longevity risk. However we urge caution against revisions that may encourage short-term perspectives. Just as the original Principle was focused more on assets (possibly a function of the prevalence of scheme surpluses that existed in 2001), the prevalence of scheme deficits has caused the current proposal to focus too heavily on liabilities.

For the Principles to remain effective, they must be forward looking, and therefore present a balanced approach to consideration of strategic asset allocation and liability

management. With this in mind, the proposed Principle would perhaps serve trustees better if it made reference to both asset selection decisions and the need to relate these to the form and structure of liabilities.

The need to balance asset allocation with a focus on scheme liabilities is set out in our pension trustee Code under Principle 7, as well. The specific guidance on this issue encourages trustees to (p.8):

“Select investment options within the context of the stated mandates or strategies and appropriate asset allocation”

and to:

“Consider the suitability of investments given the needs of the pension scheme, its future (or projected) liabilities, risk tolerance, and diversification goals.”

The need to consider the often conflicting needs of scheme members driven by their differing individual risk profiles and demographics reinforces the importance of continued focus on asset allocation. To that end, our Code’s Principle 7 also emphasises that trustees:

“Work to achieve the proper investment blend to reflect the sometimes competing interests among the different classes of scheme members while focusing on long-term stability and growth.”

Therefore, whilst we welcome the rationalisation of the Principle and do not object to the focus on risks and liabilities, we prefer that the Principle continue to explicitly refer to asset allocation. This should also be reflected in the supporting best practice guidance so as to present more balanced guidance for trustees.

Principle 4: Performance Assessment

Description: Trustees should arrange for the formal measurement of the performance of the investments. Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

We welcome the proposal to place greater emphasis on the need for trustee self-assessment in this revised Principle. As the NAPF review highlights, trustee performance assessment is the area where least progress has been made. We note, however, that the Government’s proposed changes omit measurement of the performance of the scheme’s managers and advisors (whereas this is explicitly stated in the NAPF’s updated Principle). Per the Consultation, this is addressed in the best practice guidance but not in the Principle description.

Our Code’s Principle 8 states that trustees should (p.8):

“Review on a regular basis the efficiency and effectiveness of the scheme’s success in meeting its goals, including assessing the performance and actions of scheme service providers, such as investment managers, consultants, and actuaries.”

To this extent, we would prefer the updated Principle to reflect the NAPF’s proposed wording, which states: *“Trustees should arrange for the formal measurement of the performance of the fund, its managers and advisers”*. This wording provides greater clarification for trustees than the Government’s proposal.

We support the Government’s description of performance assessment with respect to trustees, which states *“Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members”*. Timely, look-back reviews of trustee performance enhance accountability of the governing board to scheme members.

Principle 5: Responsible Ownership

Description: Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders’ Committee Statement of Principles on the responsibilities of shareholders and agents.

A statement of the scheme’s policy on responsible ownership should be included in the Statement of Investment Principles.

Trustees should report periodically to members on the discharge of such responsibilities.

The CFA Institute Centre advocates investment managers taking interventionist measures on behalf of beneficiaries where company management fail to act in the best interests of shareowners. Voting on corporate matters and advocating on behalf of corporate governance issues helps institutional investors (in this case, the pension scheme) protect the interests of clients (scheme participants and beneficiaries) by working to improve the long-term financial health of the companies in which they invest. In this regard, we are supportive of the ‘activism’ Principle in the Myners report. We note that the revised Principle of ‘responsible ownership’ proposes adoption of the Institutional Shareholders’ Committee Statement of Principles, in place of the US Department of Labor Interpretative Bulletin on activism (to which the Myners report referred). To the extent that the NAPF report finds industry support for this amendment (which differs only in form rather than substance), we have no objections to this proposal.

Principle 6: Transparency and Reporting

Description: Trustees should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives. Trustees should provide regular communication to members in the form they consider most appropriate.

Rationalising the Myners’ Principles of Transparency and Regular Reporting into a single Principle is clearly logical. We support the proposed revisions with their focus on trustees being clearly accountable to stakeholders and on providing regular communication to

scheme members. These are fundamental principles of ethical practice. Our Code advocates a similar perspective in Principle 10, which states that trustees should “Communicate with participants, beneficiaries, and supervisory authorities in a timely, accurate, and transparent manner.” The guidance to this principle notes the following (p.9):

“Trustees have a responsibility to ensure that the information they provide to scheme participants and beneficiaries is accurate, pertinent, and complete.”

The guidance also states the following (p.9):

“Among other disclosures, trustees have a duty to present performance information that is a fair representation of the scheme’s investment record and that includes all relevant factors.... To be effective, disclosures of information must be made in plain language and in a manner designed to effectively communicate the information.”

This reinforces our position that pension schemes should include transparent and understandable disclosures of investment activities and results.

Q3: *Would pensions fund trustees benefit from guidance on the content of reporting against the updated principles?*

We concur with the Government that prescriptive measures on reporting may lead to ‘boilerplate’ disclosures, which are not in the best interests of beneficiaries. Boilerplate disclosures provide little, if any, substantive and meaningful information. However this needs to be tempered against the need to ensure sufficient quality in the information presented to beneficiaries. To this extent, we believe that guidance would be beneficial, provided that it is not overly prescriptive.

Q4: *Should the proposed Investment Governance Group consider the need for guidance on the location of reporting by trustees on their application of the principles?*

We do not believe that the location of reporting is a significant issue. Provided that scheme members receive adequate information, it is of lesser importance where this information is reported. Consideration of this matter would not be an efficient use of the Investment Governance Group’s resources.

Q5: *Should the proposed Investment Governance Group own the updated principles (on the basis set out in Annex B)? If yes, are the proposed Terms of Reference for the Investment Governance Group (in Annex B) the right ones?*

Industry ownership of the Principles is important because it ensures an alignment of interests between those who oversee the Principles and those who implement them. It should also raise the level of knowledge and expertise of the oversight body. These factors should lead to efficient outcomes for scheme participants and beneficiaries. Additionally,

widening the ownership of the Principles beyond Government should strengthen the spirit of voluntarism inherent in the Principles. The terms of reference for the Investment Governance Group appear appropriate and complete.

Q6: Should the DC principles be updated by the Investment Governance Group to reflect the changes to DB principles and those market changes affecting DC provision?

To ensure consistency, it would be appropriate to update the DC Principles. As noted in the NAPF review, the DC market is growing and is likely to become the dominant form of pension scheme in the future as many defined benefit (“DB”) schemes are closed to new members. For the Principles to remain relevant and forward looking, it is important that they cover this increasingly important segment of the market. Furthermore, omission of DC schemes from the Principles would leave an increasingly large part of the market for pension provision out of focus for governance issues.

We therefore believe that the Investment Governance Group should take on the task of updating the DC Principles and ensure that DC schemes assume greater prominence in the future to reflect the evolving nature of the pensions market.

Q7: Should the Investment Governance Group take forward work to help small schemes in their application of the updated principles?

The CFA Institute Centre believes the Group should work to help small schemes apply the Principles. We note from the NAPF review that compliance is lowest amongst small schemes (given their relative lack of resources, knowledge and understanding). This indicates that help is needed for such schemes. More importantly, if trustees are not effectively applying or complying with the Principles, then scheme beneficiaries will be disadvantaged.

To ensure that all groups of beneficiaries have access to the benefits of the Principles, we advocate that the Investment Governance Group undertake work to help small schemes. We recommend that this work take the form of devising a set of best practice guidance and toolkits tailored for small schemes rather than creating a separate set of Principles specifically for small schemes (an option considered in paragraph 7.9 of the Consultation). We believe that this would be the most efficient use of resources and would generate the most effective outcomes.

Q8: Should the proposed updated principles be adopted for LGPS use and LGPS stakeholders be involved in the Investment Governance Group process?

A consistent set of Principles and coverage of all segments of the market would be desirable. We note the success of the implementation of the Principles by Local Government Pension Schemes (“LGPS”) (as highlighted in the NAPF report), therefore it seems sensible that adoption of the Principles, in their proposed updated form, continue. We encourage the inclusion of LGPS stakeholders into the Group as they represent an important pension fund constituent, particularly in the DB arena. However, we strongly



urge one significant restriction on their inclusion. That is that their representatives are politically neutral, i.e selected from officers and not elected members or their political policy advisors. Oversight of the Principles should be free from political considerations, which may conflict with the best interests of scheme participants and beneficiaries.

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