

Honing Investment Skills

Top tips for pension fund trustees



About UKSIP

UKSIP has some 5,000 individual investment professionals as its members. Many are, or will become, industry leaders. It oversees the Investment Management Certificate, the UK entry level examination of choice for investment management and advice. UKSIP supports ASIP, CFA and IMC investment professionals with an active professional development programme, *Professional Investor* - UKSIP's monthly journal - and a CFA support programme for candidate members.

UKSIP also operates as one of the largest member societies of the CFA Institute, the international body which oversees the CFA qualification. Both UKSIP and the CFA Institute support ethical investment practices and represent the views of their members on key advocacy issues.

About Capital Cranfield Trustees Limited

Capital Cranfield provides professional independent trustee services to occupational pension schemes, bringing experience, judgment and the relevant skills that ensure fairness, efficiency and good governance. Today an independent trustee can bring comfort to members, employers and lay trustees. Capital Cranfield strives to work with the advisers to each scheme, helping the trustees to get the best possible service and value from them.

About the author

Bob Bridges joined Capital Cranfield as Managing Director in January 2003 from Legal and General Investment Management. He has served on committees of the NAPF, PMI and the SPC. As well as being a committee member of The Independent Pensions Trustee Group, he is also Chairman of the PRA, an educational charity which helps people cope with changes from mid-life onwards.

1

Do not make decisions on anything you do not understand

'The basic principles are not difficult'

Every complex subject can be broken down into a series of understandable elements – investment is no different. With appropriate explanation – one to one if possible – the basic principles are not difficult. Investment managers and advisers, like experts, use jargon. Cut out the jargon and everything becomes easier to understand. The Pensions Act 2004 sets out specific requirements for knowledge and understanding. The Pensions Regulator will publish a Code of Practice in due course. The detail is not yet known but consultation so far suggests a sensible approach is being taken. The key aspects on investment will be identified and trustees will be expected to have a broad knowledge of some and a deeper understanding of others. This will form the template for training.

Trustees should recognise gaps in their own and the trustee board's knowledge. No trustee should be a party to a decision where they do not understand the issues. Seeking guidance from other trustees, from sub committees or externally from those with knowledge is a reasonable approach.



2

Involve the employer

'An agreement on funding must be reached'

A sound working relationship with the employer is crucial, particularly now as many pension funds have significant deficits. The financial support the employer is willing to give is important, but not as important as the ability to deliver. The pension fund in deficit is an unsecured creditor of the employer, with a long term repayment or funding plan in place. The natural position for the employer is to seek to maximise future returns, with the emphasis on equities, while the trustees may seek more security through a greater weighting in bonds.

The strength of the employer's covenant to the fund and the ability to cope with volatile contributions will influence asset allocation.

Trustees are under a statutory duty to consult the employer about investment strategy, and an agreement must be reached which provides a sound basis for future funding. Both the employer's and the trustees' positions must be understood by each other.





'The pension fund in deficit is an unsecured creditor of the employer, with a long term payment or funding plan in place'

3

Know what risks you are taking

'Understand the best and worst case scenarios'

It is essential that trustees understand the nature of the Scheme's liabilities to determine investment strategies. All strategies carry risks and – in theory – higher returns can only come from taking greater risks. Trustees need to be aware of the best and worst case scenarios and the most likely outcomes of their investment strategy. They also need to understand who is bearing the risks and whether that party is aware of them. It is also important to monitor the results from the investment structure put in place.



It is often said that investing for pensions is long term, and there is pressure for long term investment manager mandates. In reality, investment strategies must be seen to be working over relatively short periods. Monitoring investment returns but not necessarily changing strategy, must be done regularly.

Identify and manage conflicts of interest

4

'Investment strategy affects contribution levels'

Conflicts of interest will exist on every trustee board. Managed properly they can be a source of strength, offering viewpoints from different perspectives on many issues. But they can also make sound governance more difficult to achieve, particularly on investment issues. The investment strategy will affect contribution levels.

Potential conflicts of interest can include a need for company directors to set aside commercial self interests. Also, member nominated trustees are most often current employees, whereas – for many schemes – former employees often represent the bulk of the liabilities.

'Conflicts of interest... managed properly can be a source of strength'



5

Focus on the Statement of Investment Principles (SIP)

'Decisions should be cross-checked

A comprehensive clearly written SIP, reviewed regularly, is a cornerstone for developing and following a sound investment strategy. All those involved in taking investment decisions should be very familiar with the SIP – reading it before each investment meeting sounds excessive but focuses the mind, and becomes progressively less demanding. Every significant decision should be cross-checked with the SIP.

This all sounds obvious, but in practice many SIPs are based on an adviser's or a manager's template, are not necessarily an easy read and are seldom referred to by trustees. The Pensions Act 2004 requires trustees to be 'conversant' with key documents – the SIP is one of them, so make sure you read and understand it.





Use advisers who will advise you

'Expect clear written recommendations'

Almost all advisers are very knowledgeable, experienced and behave in a very professional manner. But they are human and they work for firms which are competing with other firms for business. They have their own 'products', and their ways of doing things. These may not be suited to your needs.



Some advisers explain a number of options – but leave you to make all the decisions. This is not giving advice. Advice is – 'these are the options and given your circumstances and attitudes we believe the most

appropriate course of action for you is to...!' Clearly matters of chemistry, such as which investment manager to appoint – having decided on which style of manager etc – can best be done by the trustees. There are very few decisions trustees have to take where they cannot expect clear written recommendations. Trustees should question and not always accept the advice given, but it will have provided them with a sound platform for taking decisions.

7

Insist that investment managers' reports meet your needs

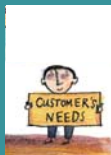
'The information you need when you need it'

Investment managers, particularly for pooled funds, want to standardise reporting as much as possible. However, trustees have to monitor the investment strategy they have put in place. Trustees need to be sure that the manager is following the SIP and delivering the results expected within the framework agreed.

Reviewing past performances is straightforward, but how was it achieved? Was it skill over luck? What risks were taken? What were the fees and costs? Looking forward, what are the investment manager's views and strategy? How much confidence do they have concerning these?

Like any business, investment organisations change over time, sometimes rapidly. Is it still the manager you appointed? Is the corporate structure stable, are the same people managing the money and liaising with you? Business success can cause organisations to change as much as business failure. Are they gaining or losing clients?

This all suggests expensive one-off reporting – but it need not. Technology increasingly makes it possible for trustees to receive, or take, the information they need when they want it. So decide what you need and ask for it.





'Like any business, investment organisations
change over time, sometimes rapidly.

Is it still the manager
you appointed?'

8

Develop your own culture

'The way we do things round here'

The very nature of the trustee selection process means that there are regular changes in the trustee board. Developing agreed trustee board procedures can help bring about some consistency to decision making. Clearly trustees need to collate information and consider fully all major investment issues, particularly those relating to asset allocation and risk. Board procedures help as trustees meet at best quarterly and focus on investment less frequently. Investment advice is often based on market conditions which are constantly changing.



The prospect of good investment results will be improved if trustees consider fully, act decisively and implement quickly. Keeping a full record of this process is crucial – not everything works out as planned.

'With employers, members, advisers and one another'

It is in everyone's interests to be open and inclusive, and make as much information as possible available to all parties. There are, of course, times when confidentiality is crucial and costs need to be borne in mind. As with manager reporting, modern technology makes access to information easy and more economic. A trustees' section in a pension scheme website is the ideal place to report on key investment issues. Since not every investment decision will bring the desired results – certainly in the short term – giving relevant background information explaining under/over performance will help avoid criticism based purely on the benefit of hindsight.

Members need to know that trustees are alive and, in particular, active.



10

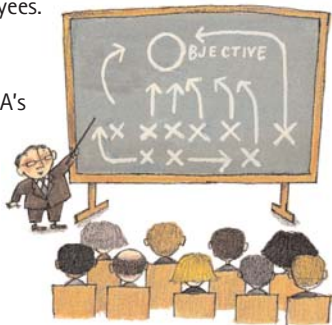
Take defined contribution seriously

'Education, education, education'

All of the first nine 'tips' apply equally to Defined Contribution (DC) schemes. Trustees do not always give sufficient time to the investment aspects of DC, especially where the pension scheme contains both DB and DC elements. This is natural because often the bulk of the assets are still backing DB liabilities, but most members are, or will be, in the DC plan.

In particular take member communication seriously. Take responsibility for ensuring that members understand the investment options, and that they have access to advice. Trustees can help members by encouraging financial education among employees.

A starting point is to provide access to the PRA's 'learnaboutmoney' financial education programme¹.



¹The PRA is a national charity which aims to help people cope with changes they face from mid-life onwards. The 'learnaboutmoney' programme is available online (www.learnaboutmoney.org), on CD Rom and in hard copy workbooks.

Useful contacts

Association of British Insurers

Tel: 020 7600 3333 www.abi.org.uk

Department for Work and Pensions

Tel: 020 7962 8000 www.dwp.gov.uk

The Financial Services Authority

Tel: 020 7066 1000 www.fsa.gov.uk

Institute of Actuaries

Tel: 020 7632 2100 www.actuaries.org.uk

National Association of Pension Funds

Tel: 020 7808 1300 www.napf.co.uk

Occupational Pensions Regulatory Authority

Tel: 01273 627 688 www.opra.gov.uk

The Pensions Advisory Service

Tel: 0845 601 2923 www.opas.gov.uk

Pensions Management Institute

Tel: 020 7247 1452 www.pensions-pmi.org.uk

The Pensions Ombudsman

Tel: 020 7834 9144 www.pensions-ombudsman.org.uk

The Pension Protection Fund

Tel: 0845 600 2541 www.pensionprotectionfund.gov.uk

The Pensions Regulator

Tel: 0870 606 3636

Email: customersupport@thepensionsregulator.gov.uk

Society of Pension Consultants

Tel: 020 7353 9296 www.spc.uk.com

No mention of Myners?

By following these tips trustees will be going a long way towards complying with the Myners Principles.



UK Society of Investment Professionals
4th Floor, 90 Basinghall Street, London EC2V 5AY
Tel: 020 7796 3000
www.uksip.org

Capital Cranfield Trustees Limited
5th Floor, 11 Burton Street, London W1J 6P
Tel: 020 7629 1124
www.capitalcranfield.co.uk