

Highlights from HMT's 'Myners principles for institutional investment decision-making: review of progress'

December 2004

"The Government has concluded that the voluntary approach is beginning to work, but more effort is needed to ensure that problem areas identified by the review are addressed. It believes that pension funds would better serve their members' and sponsors' interests if the best practice embodied in the Myners principles were to be strengthened and amplified.

The Government proposes that the Myners principle in relation to effective decision making (principle 1) should be strengthened and therefore proposes to add three new elements to the principle:

- the chair of the board should be responsible for ensuring that trustees taking investment decisions are familiar with investment issues and that the board has sufficient trustees for that purpose. For funds with more than 5,000 members, the chair of the board and at least one-third of trustees should be familiar with investment issues (even where investment decisions have been delegated to an investment subcommittee). *In this context, familiarity with investment issues means being sufficiently expert to be able to take investment decisions, rather than delegate them.*
- funds with more than 5,000 members should have access to in-house investment expertise equivalent at least to one full-time staff member who is familiar with investment issues.

The Government further proposes:

- to amend the principle on expert advice (principle 4) so that contracts for investment advice should be split between advice on strategic asset allocation and advice on fund manager selection.

On reducing the mismatch in perceptions between fund managers and trustees over the length of performance time horizons, the Government proposes to clarify and simplify the relevant element of principle 5 (explicit mandates) to state that trustees should agree mandates with:

- clear timescale(s) for performance measurement and evaluation.

The Government notes in particular the concrete steps by the industry – in the form of the 'Marathon Club' of senior institutional investors – to look for practical ways to reduce the barriers to the establishment of long-term mandates with fund managers.

The Myners report recommended that the Government should legislate for shareholder engagement. Following discussions with the Institutional Shareholders Committee (ISC), the Government agreed to the ISC's proposal to pursue this recommendation, initially voluntarily, through a set of ISC principles for engagement, and to assess progress after two years. The Government believes that effective engagement requires informed consideration and judgement, and cannot be achieved by a 'box ticking' approach based on mere formal compliance. The industry needs to ensure that the ISC principles have been integrated into investment decision-making and asset management processes, and that the quantity and quality of resources and people committed to engagement, and the level of qualitative reporting provided by fund managers, are appropriate. The Government is awaiting the results of the ISC's review of progress before reaching its own assessment of the extent to which these principles have been successful in achieving this behavioural change.

To remove ambiguity and make clear the responsibility of trustees for ensuring appropriate engagement is undertaken, the Government proposes to revise principle 6 (activism) to replace the reference to the US Labor Department Interpretative Bulletin with an analogous requirement to comply with the ISC principles:

- trustees should comply with the ISC statement of principles on the responsibilities of institutional shareholders and agents, and ensure that the principles are incorporated into fund managers' mandates. In line with the principles, trustees should also ensure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and how they measure the effectiveness of this strategy.

The original Myners review argued that a good practice model, backed up with disclosure on a 'comply-or-explain' basis, can be a powerful force for behavioural change. It therefore proposed that pension funds should set out annually in their SIP how they are implementing the principles and explain the reasons why they have decided to depart from any of them.

Disclosure to date has been patchy and, moreover, in general, been less rich and informative than envisaged by the original review. In part, this may reflect the relatively weak collective pressure which fund members are able to bring to bear on trustees. There are signs that other external pressures to act on the Myners principles are growing. Over time, partly in response to such pressures, commentary

and disclosure is likely to improve. But the Government considers that there would be benefits in making progress more quickly.

The Government has decided not to require schemes to disclose their compliance with the Myners principles in their SIP. Instead, it sees merit in a voluntary, independently-compiled report on implementation of the principles by trustees, akin to the FRAG reports commissioned by custodians to demonstrate to clients their compliance with various internal control procedures. This would be more flexible than mandatory disclosure and the reports would contribute to an informed commentary on the quality of compliance, helping establish benchmarks of good practice, providing information to members and other stakeholders, and helping trustees validate their decision-making procedures more effectively. The Government therefore proposes to:

- establish a working group, chaired by the Treasury, with the NAPF and other stakeholders to develop further the practicalities of a 'FRAG-style' report on implementation of the principles.

The Government also proposes to improve the quality and availability of information provided to members and stakeholders by amending principle 10 (regular reporting) to state additionally that:

- trustees should make available assessments of their own performance to the scheme membership; and
- trustees should post on a fund website the key information they provide annually to fund members. For funds with more than 5,000 members, it is good practice to have a website dedicated to the fund.

The Government is now consulting on the proposed changes (**comments by 16 March 2005**).

The NAPF has agreed to undertake a further review in 2007 of the progress its members are continuing to make against the Myners principles, and put the results to Government. In light of the NAPF's evidence, the Government will assess the degree to which the principles have resulted in behavioural change and consider whether there still remains a need for further policy action, by the end of 2007."