

MYNERS, P., 2001. *Institutional Investment in the United Kingdom: A Review.*

UKSIF summary, 2009.

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I. Key points

- **Purpose of the review:** to establish the extent to which institutions' approaches to investment decisions are rational, well-informed, subject to the correct incentives and undistorted.
- **Main issues found:**
 - Pension fund trustees do not have the resources (rarely paid; often unsupported by in-house staff) or the expertise to be asked to take crucial investment decisions.
 - Investment consultants are placed a high burden of responsibility, although they are a small group with low profits and little room for specialisation.
 - Performance of advisers is rarely measured.
 - Asset allocation, which can be determinant to investment performance, is under-resourced.
 - Fund managers are being set objectives which bear little relationship to the ultimate pension fund's objective.
 - Many objectives are set in a way that gives fund manager incentives to herd.
 - There is vagueness about the timescales over which fund managers' performance is to be judged.
 - Fund managers remain unnecessarily reluctant to take an activist stance.
 - Broking commission is subject to insufficient scrutiny.

- **Pension funds**

- Many trustees are not expert in investment: 62% of the trustees do not have professional qualifications in investment/finance, 77% have no in-house professionals and over 50% received less than 3 training days
- Larger schemes are more likely to have the resources to recruit and train more knowledgeable trustees and the use of professional trustees had grown in recent years.
- There is no legal requirement for trustees to have any particular level of expertise in investment matters, only that they obtain proper advice about it (that changed with the statutory requirements of the Pensions Act 2004)
- Pension funds and herding:
 - (a) hire the same management firms and brands¹;
 - (b) prefer peer benchmarking² (rely on historic performance) and
 - (c) short-termism (including quarterly trustees' meeting and consequent quarterly appraisal of fund managers).
- The pension scheme's sponsor could be a source of support for the fund, but, in fact, there are barriers against it: the pension scheme is separate from the sponsor; the pension is viewed as a human resource issue and sponsor companies' incentives in relation to pension fund investment are distorted.
- The review believes that advice alone is an inadequate basis for decision-making if trustees cannot criticise the information received.
- Pension funds have 2 approaches to investment:
 - Managed fund (or peer group): strategic allocation and security selection are both managed by a fund management company or more than one.
 - Customised benchmark model: trustees set the asset allocation strategy - invest in one asset class or in more than one asset class under index benchmark (strategic asset allocation remains with trustees and stock selection decision remains with the manager) or peer group performance.
- The sponsor has the same commercial incentives as the pension funds: the more effective the investment decision-making, the

¹ "Most pension funds naturally wished to have their money invested by the same small number of management firms" (Myners 2001, p. 75)

"It is difficult to be shortlisted for a mandate – and even more difficult to be selected – for a firm which is not well-established, with an unfamiliar name" (Myners 2001, p. 81)

² "Most pension funds naturally wished to have their money invested by the same small number of management firms" (Myners 2001, p. 75)

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more cost-effectively the sponsor can provide pensions to its employees.

Defined Benefit	Defined Contribution
Sponsor bear the investment risk (one risk appetite)	Members bear the investment risk (different risk preferences)
percentage of the employee's salary on leaving the scheme, taking into account the number of years spent in the scheme	the value of the pension is determined by the value of the annuity which the pool of assets accumulated in the fund at retirement can purchase
Most DB schemes are being closed.	All new pension schemes are defined contribution.
Both the contribution from the employer and the employee are higher.	Both the contribution from the employer and the employee are lower.
The aim is liability-related return.	No asset-liability modelling
80% of the market	20% of the market
Pooling of members' risk	No pooling of members' risk

- **Actuaries and investment consultants**

- The investment consulting industry is small and highly concentrated with low levels of customer switching.
- Investment consultants are highly influential in investment decision-making and the range of issues is broad and complex: Higher fees could attract a greater and more diverse range of firms into the market.
- Trustees typically pay considerably more to have their securities portfolios actively managed than for asset allocation advice:
- They derive their brand strength largely from their actuarial history (advertising to develop brand loyalty is not particularly strong in the market).
- Pension funds usually employ investment consultants and actuarial advice from the same company, but this is not defined as uncompetitive market.
- The Pensions Act 1995 requires trustees to take proper advice before investing.
- Pension funds have no formal means of judging the success of asset allocation decisions.
- The industry has low levels of customer switching.
- Investment consulting firms reported difficulty in recruiting and retaining skilled staff, as competing with the fund managers.
- The advice is uniform, insufficiently specialised and poorly equipped to deal with alternative asset classes.
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- **Fund managers**
 - The traditional cited culprit of short-termism is the quarterly trustees' meeting with fund managers, which leads to quarterly appraisal of managers, making fund management firms' internal appraisal and monitoring systems focus strongly on short-term performance. On the other hand, trustees and advisers say that they are not concerned about short-term.
 - Fund managers are reluctant to implement active shareholder engagement on behalf of the clients to tackle companies' underperformance. Some of the reasons are culture to avoid public confrontation and little incentive to adopt activist strategies from manager selection and performance measure.
 - It is difficult to be shortlisted/selected for a mandate if the firm has not a familiar name.
 - Switching firms is simple and frequent: 1/3 of schemes had changed investment manager in the past 12 months
 - The level of concentration in the industry is not particularly worrying.
 - Fund managers are increasing professional skills.

- **Investment banks**
 - Currently, fund managers contract the services of the sell-side on behalf of the institutional investors and do not disclose the process by which the brokers' fees are negotiated. Clients' interests would be better served if fund managers were required to absorb these costs as a cost of the business of fund management, since they would be more careful in managing the costs.

- **Life insurance**
 - Most of the business which life insurance is now not insurance, but savings and investment.
 - IFA's play a very important part in advising customers on which product to buy.
 - Competition in the life insurance takes place on the basis of bonuses paid to customers instead of investment performance.
 - The industry remains dominated by companies with long histories.
 - Life insurance products are retail products.
 - Insurance companies' asset must be adequately diversified and spread to avoid excessive reliance on any particular category of asset. There is also a requirement for linked products that assets must be readily realisable³

³ available and able to be sold within 7 working days for 97.5 of the market value

- **Private equity**
 - Private equity refers to the provision of risk capital by specialist investment managers to unquoted companies.
 - Private equity faces the problems of illiquidity and the need of specialist investment advice about the asset class.
 - Greater resources spent in the asset allocation process, more specialist advisors and more knowledgeable trustees will have a positive impact on private equity.
 - UK private equity market is not as developed as in the US: the US private market is more mature and pension funds are larger to invest
 - The performance of private equity should be measured on long-term returns.
 - Likely benefits: national productivity gains, employment creation and technology diffusion.
 - The UK private equity is benefited from foreign investors.

- **Myners Principles:**
 - **Principle 1 - Effective Decision-Making**
 - Decisions should only be taken by those with the right skills and expertise
 - Trustees should ensure that they have sufficient in-house staff to support them in their investment responsibilities.
 - It is good practice for trustee boards to have an investment subcommittee to provide the appropriate focus.
 - **Principle 2 - Clear Objectives**
 - Trustees should set out an overall objective for the fund that represents their best judgement of what is necessary to meet the fund's liabilities and taken account of their attitude to risk.
 - **Principle 3 - Asset Allocation**
 - Strategic asset allocation decision should reflect the contribution they can make towards achieving the fund's investment objective.
 - **Principle 4 - Expert advice**
 - Funds should contract separately for actuarial and advice services (from 2004 Review, also separate for fund manager selection).
 - **Principle 5 - Explicit mandates:**
 - Trustees should agree with fund managers the objective, benchmark, risk parameters, approach and timescale in the mandates
 - Trustees should have a full understanding of the transaction-related costs they incur, including commissions.
 - **Principle 6 - Shareholder activism:**

- Trustees should ensure managers have an explicit strategy on engagement (from 2004, should also comply with the ISC's Statement of Principles)
- **Principle 7 - Appropriate benchmarks**
 - Trustees should consider whether index benchmarks are appropriate; whether passive or active management would be more appropriate
- **Principle 8 - Performance measurement**
 - Arrange for measurement of the performance of the fund and formal assessment of performance and decision-making delegated to advisers and managers
- **Principle 9 - Transparency**
 - The Statement of Investment Principles should set out who is taking decisions, structure selection, investment objective, asset allocation strategy, projected investment returns, mandates to advisers and managers and fee structures and reasons they have been selected.
- **Principle 10 - Regular reporting:**
 - Trustees should publish the Statement of Investment Principles, results of monitoring, key information to members (from 2004, include information on a website).

II. Key quotes

- “Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.” (Keynes 1936 in Myners 2001, p. i)
- “My strong preference, however, is for industry - if it is willing - to drive forward itself, legislation, though it might in the end prove necessary, is likely to be a blunt instrument to tackle the kinds of problem I have described” (Myners 2001, p. 2).
- “Fund managers are being set objectives which appear to bear little coherent relationship to the ultimate objective of the pension fund” (Myners 2001, p. 2)
- “Larger schemes are more likely to have the resources to recruit and train more knowledgeable trustees” (Myners 2001, p. 5)
- “...trustees tend to feel that they lack the expertise to do so (taking decisive action or changing direction), and advisers that they lack the power to make decisions...” (Myners 2001, p. 6)
- “The review believes that advice alone is an inadequate basis for decision-making” (Myners 2001, p. 7).
- “...what the pension fund really needs: a liability-related return...” (Myners 2001, p. 9)

- “The aim of defined benefit pension funds is to pay the pensions that members have been promised. Their primary objective is therefore to achieve a certain liability-related level of return” (Myners 2001, p. 9)
- “Members of a defined contribution scheme can take little comfort from discovering that their fund has beaten the returns of the peer group average or median, if the rest is below the level required to produce the pensions that they expect” (Myners 2001, p. 9).
- “A culture of pension fund governance would develop in which trustees would treat their responsibilities very much like the job of running a company” (Myners 2001, p. 16)
- “From mid-1990s, however, defined benefit schemes have increasingly begun to close to new members or even to be wound up, their place taken by defined contribution schemes. This change is partly driven by a shifting labour market and wider economic conditions. But a further factor has been the increased costs to employers of providing defined benefit schemes for their employees...” (Myners 2001, p. 29).
- “Trustees have no legal (or, in many cases, commercial) incentive, nor any duty, to become educated in investment matters” (Mayers 2001, p. 42)
- “...it is clearly in sponsor companies’ interests to ensure that their pension fund is well invested. The provision of resource - in particular, informed and skilled staff - has a key role to play in achieving that” (Myners 2001, p. 49).
- “...peer group benchmarks create powerful herding incentives for asset allocation” (Myners 2001, p. 56)
- Asset-liability modelling “is widely used by pension funds and insurance companies to help set long-term asset allocation strategies appropriate to the risk tolerance and liabilities of the institution” (Myners 2001, p. 57).
- “The present level of in-house investment expertise of most pension funds is so modest that spending relatively small sums on hiring an in-house specialist or recruiting professional trustees almost certainly yield benefits” (Myners 2001, p. 60).
- “A situation where one party has legal responsibility for taking a decision but, lacking much of the necessary information and expertise, relies so heavily on a second party, is not conducive to good decision-making” (Myners 2001, p. 60)
- “...a pension fund will usually pay many times less for asset allocation advice than for fund management” (Myners 2001, p. 60)
- “Passive management is a low-cost alternative to active management” (Myners 2001, p. 81).
- “Managers are paid a percentage of funds under management, with the result that they are rewarded not specifically for adding value relative to the benchmark, but for an increase in the size of the portfolio, which

might equally be caused by a rise in the value of the market as a whole, something which they do not control" (Myners 2001, p. 84)

- "Merely meeting senior management and expressing polite reservations about strategy is not sufficient, if it is not effective" (Myners 2001, p. 90).
- "Pension fund trustees are - in an almost legendary sense - older, experienced and usually very conservative. They typically have only a limited amount of time to spend on the pension fund, and so will look to others for help and guidance." (Mansley 2001, p. 93)
- "In a defined contribution scheme, the individual member bears the investment risk. This does not mean, however, that the individual makes the investment decisions." "In the first place, a number of defined contribution schemes offer only one investment option to members." "Even where a range of options exist, many funds offer a default option" (Myners 2004, p. 99).
- "But it is quite clear that many members have only limited understanding of and interest in the management of their pension, and are neither particularly competent nor in many cases willing to take investment decisions themselves" (Myners 2001, p. 103)
- "But in defined contribution schemes, the risk falls on individuals, each of whom is likely to have very different risk preferences. It is not practical for trustees to take account of the individual risk preferences of each individual member." (Myners 2004, p. 103)
- "The more they offer, the less likely it is that members could successfully claim their investment choice had been restricted. But equally, the more options they offer, the more complicated the decision becomes for members" (Myners 2004, p. 103)
- "Concern has frequently been expressed to the review that contribution levels to defined contribution (as opposed to defined benefit) schemes are too low to provide the sort of retirement income anticipated by most people" (Myners 2001, p. 106).
- "It is generally accepted that the population as a whole has a poor understanding of investment and savings issue" (Myners 2001, p. 137)
- "Insurance companies do not compete on the basis of the investment performance of the underlying fund but rather, on the level of reversionary and terminal bonuses paid to customer." "...it is a matter of concern that competitive pressures in the industry are not primarily oriented around investment performance." (Myners 2001, p. 138-139)
- "More knowledgeable trustees with more in-house staff would be in a better position to understand the specific issues raised by private equity" (Myners 2001, p. 153).
- "...although private equity remains a niche activity, successfully backed enterprises have a disproportionate impact on national productivity gains, employment creation, and technology diffusion." (Myners 2001, p. 163)

- “When assessing the performance of private equity it is important to focus on long-term returns. Initial returns over the first two or three years can be misleading if viewed in isolation.” (Myners 2001, p. 168)
- “Private equity managers are very strongly incentivized to achieve absolute returns over a fixed period of time” (Myners 2001, p. 177).