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# Changes & Challenges after the Myners Review

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# Myners Review

- Examine institutional investment
- UK pensions relatively healthy
- Is investment industry well placed for the future?



# Treasury Concerns

- Herding
- Distortion
- Efficiency and flexibility
- Venture capital



# Addressed by Myners Review

- MFR
- Role of trustees
- Role of consultants
- Benchmarks
- Asset allocation
- Brokers commission
- Role of investment advisor
- Use of derivatives
- Venture capital / alternative assets
- Measuring consultant added value
- Fund management fees
- Insurance companies
- Equity investment vs. fixed income
- Transparency
- Shareholder activism
- Defined contribution schemes
- Pension fund surpluses
- Liability valuation



# Topics for Today

- MFR
- Defined contribution schemes
- Consultants and benchmarks
- Concept of retirement
- Financial education

# MFR Removal

*Hooray!*

- Tried to protect too much
- Why should DB members expect complete protection?
  - Other investors don't
- MFR doesn't give full protection anyway
- Non-retired members may not even get their contributions back on insolvency



# Protection

- Banks - £18,000
- Investors - £48,000
- Review's recommendation
  - Long-term scheme specific approach
    - Based on transparency and disclosure



# Transparency Statement

- Fund's investment objectives
- Who is taking decisions and why
- The mandates given to advisers/managers
- Current value of assets
- Assumptions to determine liabilities
- Planned future contributions
- Planned asset allocation
- Assumed returns and volatility
- Justification of reasonableness
- Implications of volatility



# Better Protection .... Insolvency Insurance

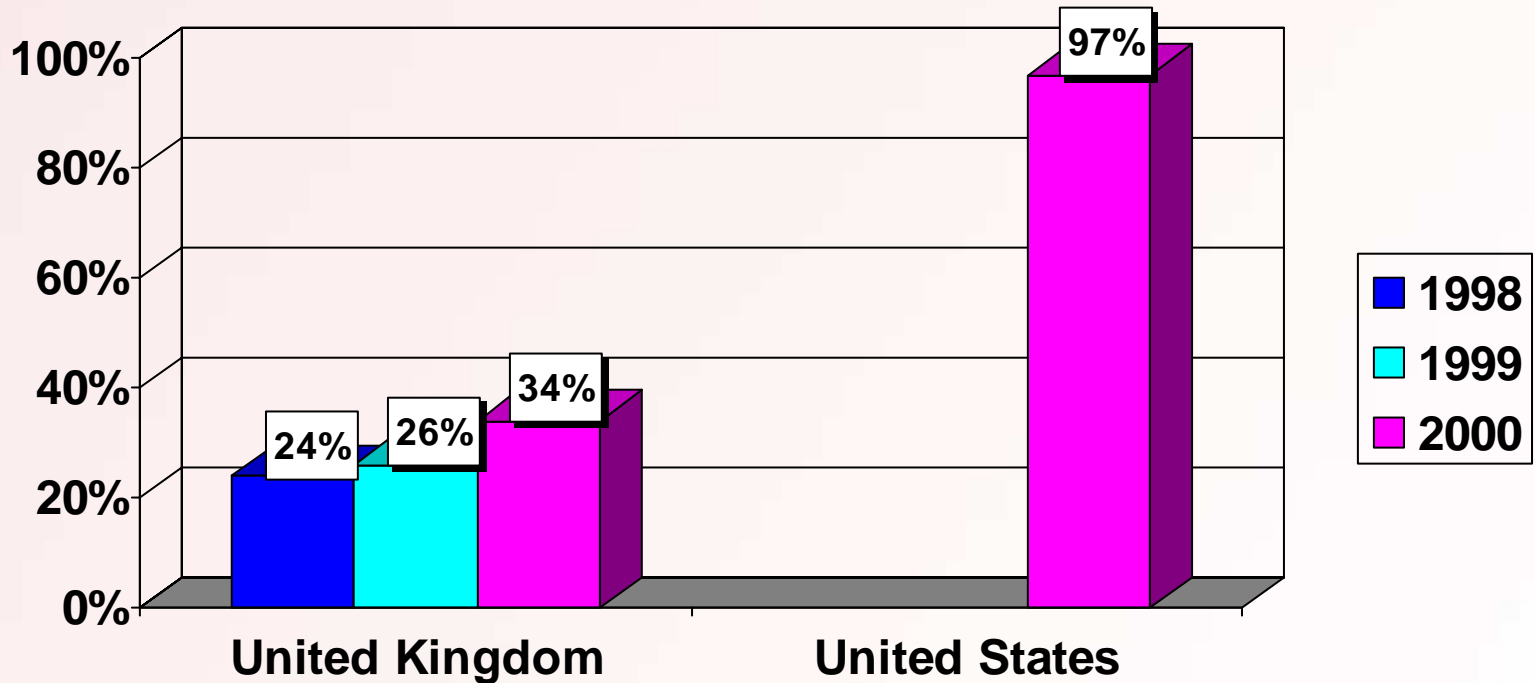
- Insurance for DB
  - Up to maximum monetary amount
- Premiums depend on funding level
- Set for 5 or 10 years at a time
- Look more creatively at insurance option



# Payment of Trustees

- Does paying trustees ensure better investment decisions?
- Provide education and training
- Extra costs for DB schemes

# Percentage of companies now using a DC plan



Source: Greenwich Associates



# DB versus DC

- DB
  - Longer retirement periods
  - Increasing cost and uncertainty
  - Schemes larger than sponsor
- DC
  - Advancing relentlessly in UK
  - Risk now rests with individual
    - But State has ultimate responsibility



# Advantages of DC

- To Member

- Portability
- Control over own funds
- More flexibility
- Possible guarantee

- To Employer

- Certainty of cost
- Avoid regulatory problems
- Increased visibility and flexibility
- **Reduce costs by lower contributions**



# Disadvantages of DC

- To Member
  - Lower employer contributions
  - Poorly designed investment options
  - No employer to make up shortfall
  - No certainty of retirement income
- To Employer
  - Not much



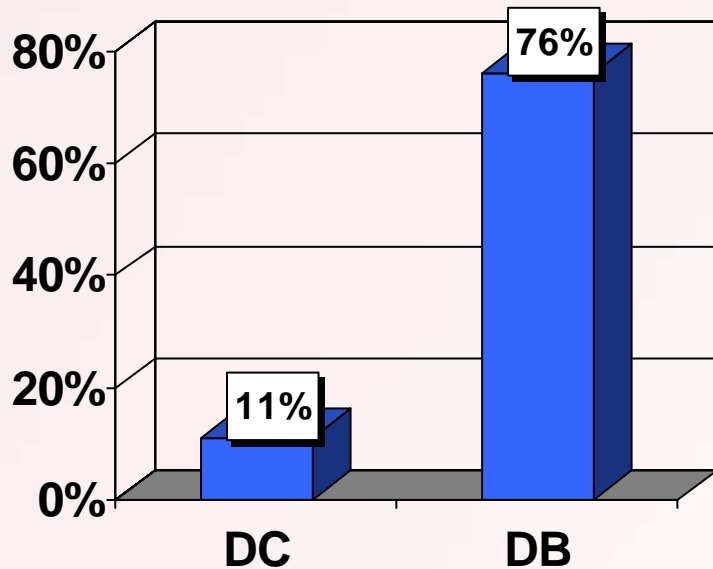
# Key Issues in Defined Contribution

1. Contributions
2. Investment performance
3. Annuities and post-retirement income regime

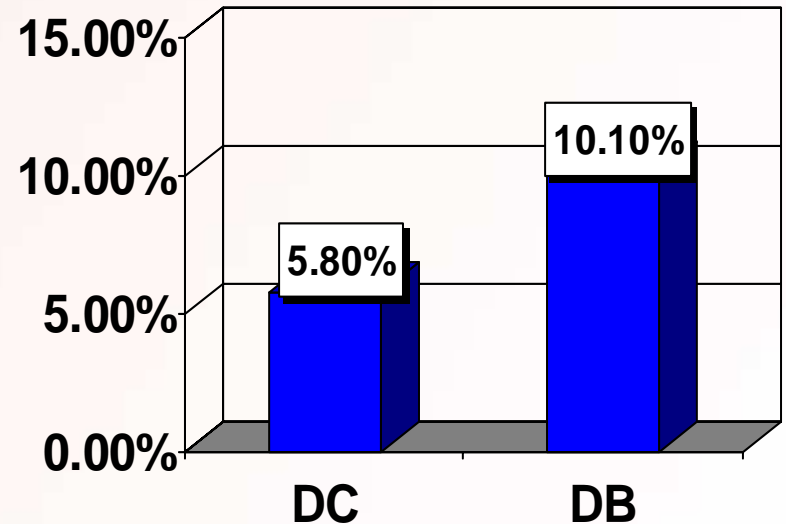
# Contributions

Government needs to investigate level of employer contribution

**% of members of non-contributory schemes with employers contributions above 6% of salary**



**Average % contribution rate from employers for contributory schemes**



# Contributions Needed to Achieve a Pension of Two-thirds of Final Salary

Age at commencement of contributions (Male)	Required contributions (% of salary)	Maximum contributions permitted by current legislation (% of salary)
25	10.9	17.5
30	13.4	17.5
35	16.8	17.5
40	21.7	20
45	28.9	20
50	40.8	25
55	64.1	30
60	129.8	35



# Investment Performance & Products

- Investment performance of:
  - DB affects SECURITY of pension
  - DC affects AMOUNT of pension
- Need for:
  - Education and guidance
  - Best practice guidelines
  - US “Safe Harbour” regulations



# DC Investment Products

- Suitable range of products
  - 23% no choice
- Well-developed default options
- Diversification to include:
  - Active
  - Passive
  - Alternative assets

# Trustees' Choice of Investment Provider in DC

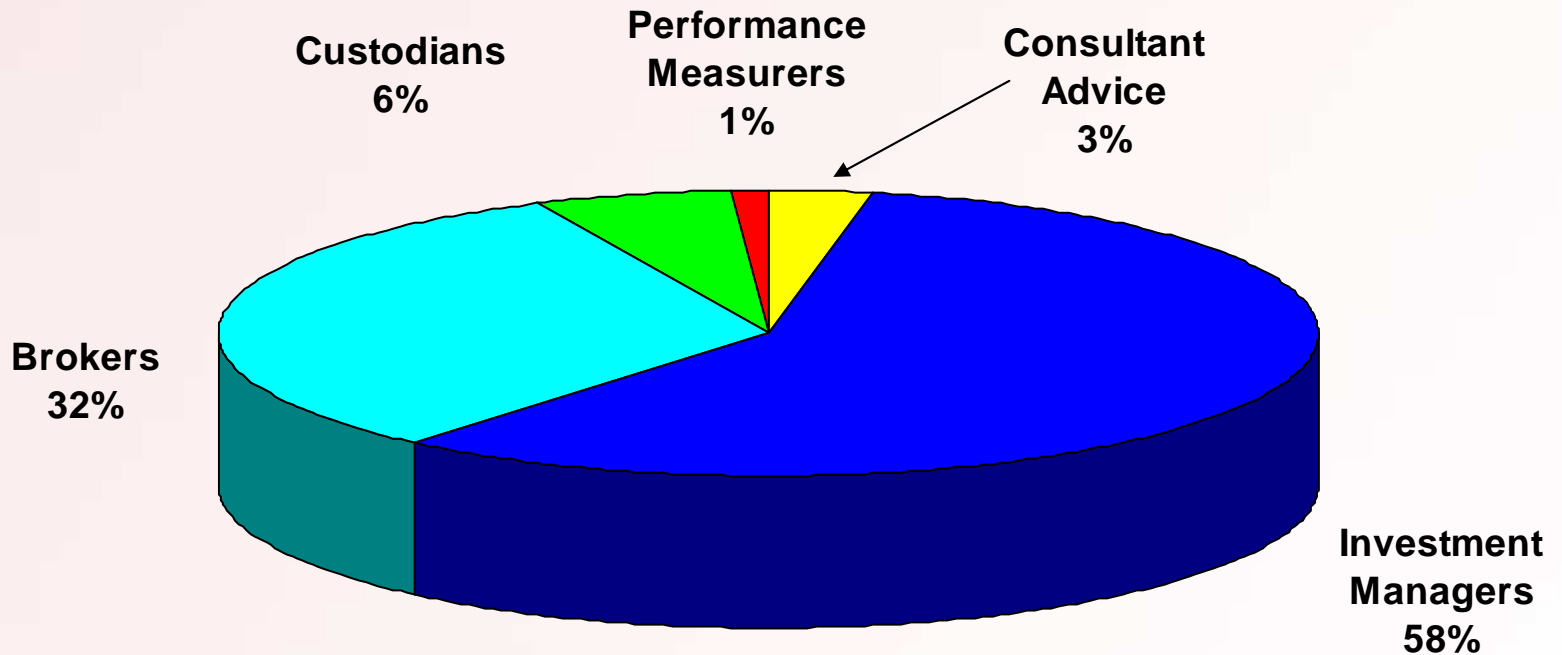
- Should depend on three main factors:
  - Availability and quality of advice
  - Broad range of investment products
  - Level of charges
- Past performance should NOT be over-riding factor

*Big responsibility.  
Big risk!*

# Consultants

*Not paid enough*

## Breakdown of Pension Fund Investment Costs



Source: Watson Wyatt



# Review Suggests

- Split actuarial and investment advice
- Higher fees for investment consultants
- Assessment of advisers' performance
- Measurement of added value
- Advisers should have specific expertise in that asset class
- Not to prohibit use of derivatives



# Intellectual Competence from Advisers

- UK consultants late to look at alternative assets
- But how should performance be assessed?
- Criteria?
- Multi-manager funds



# Performance Benchmarks

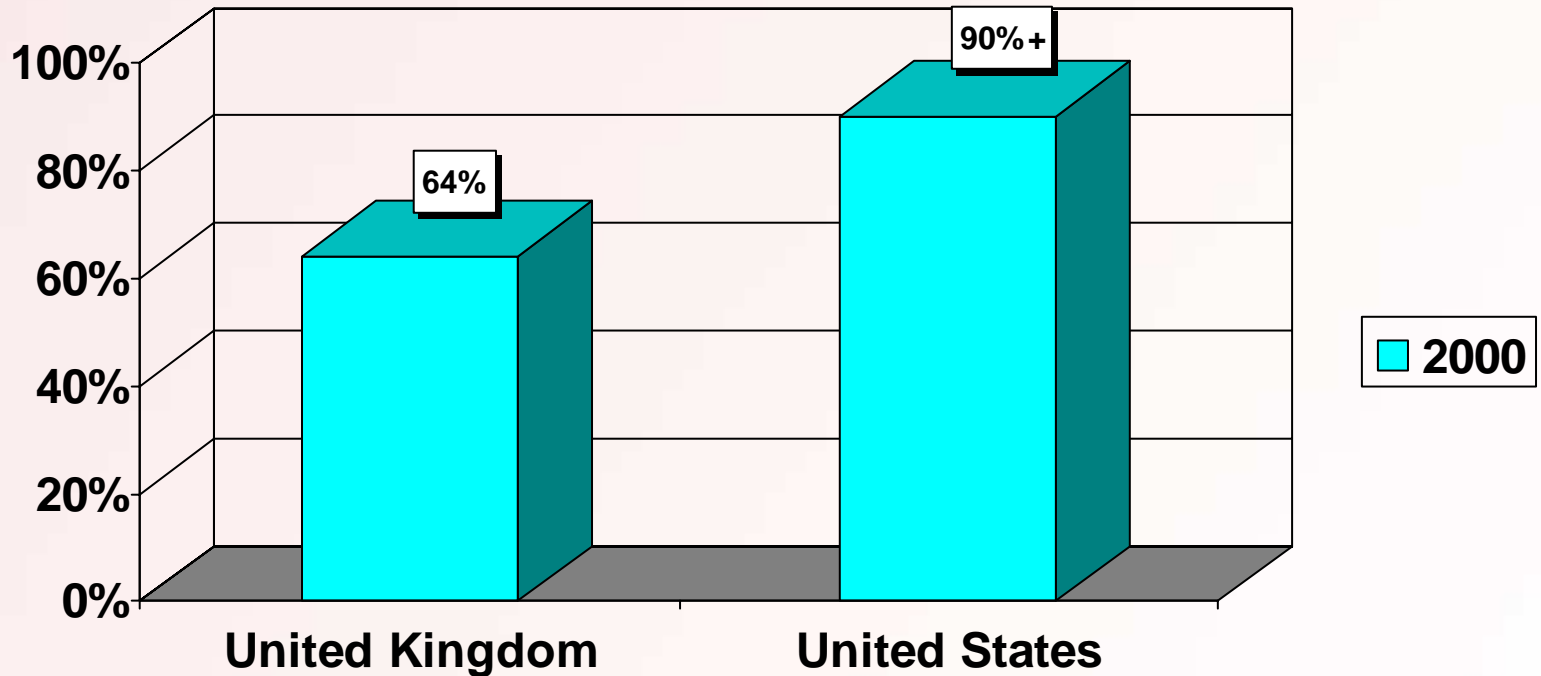
- Peer group benchmarks not appropriate for DB
- Should be tailored to each fund's needs
- Deliver a return related to each scheme's liabilities
- Use of tracking errors and risk controls needs looking at
- Herding



# Benchmarks

- Core-satellite
- Active and passive
- Specialist managers
- Risk budgeting
- U.S. well ahead
- Multi-manager approach

# Percentage of funds using speciality managers



Source: Greenwich Associates

# Percentage of funds using each type of mandate

<b>Speciality Mandate</b>	<b>United Kingdom</b>	<b>United States</b>
<b>Domestic equity index</b>	<b>33%</b>	<b>57%</b>
<b>Enhanced index</b>	<b>3%</b>	<b>21%</b>
<b>Large cap stocks</b>	<b>12%</b>	<b>83%</b>
<b>Small cap stocks</b>	<b>11%</b>	<b>73%</b>
<b>Emerging markets</b>	<b>13%</b>	<b>29%</b>
<b>High-yield bonds</b>	<b>7%</b>	<b>24%</b>
<b>Hedge funds</b>	<b>2%</b>	<b>11%</b>

*Source: Greenwich Associates*



# Equity vs. Bonds

- Review predicts increased use of fixed income
- Use of fixed income as strategic, rather than tactical asset



# Change Concept of Retirement

- Work longer
- 'Process' rather than 'event'
- More flexibility
- Account for individual differences
- Policy light years behind mortality changes



# Retirement Policy

- Lagged behind mortality changes
- Current situation unsustainable
- People draw-out for longer than pay-in
- Funding crisis
- Make whole system more affordable
- Need to focus properly on post-retirement income



# Financial Education

- Standard too low
- People don't understand
- Core curriculum subject in schools
- Investment providers in workplace
- Not just for trustees



# Challenges for Future

- MFR replacement for DB
- Get DC right
- Tailored benchmarks
- Diversification
- Change concept of retirement
- Improve financial education

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Thank you for  
listening

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