

# The role of the trustee



## Bob Bridges has 10 top tips for honing trustee investment skills

**M**any investment professionals have pension funds as clients. For a number of years now, pension fund trustees have been subjected to scrutiny by the media, by opinion formers and by Government. Their relationships with investment professionals have become more challenging, a trend which seems set to continue.

The following guidance, devised with trustees in mind, should also interest all investment professionals with whom they have dealings. The advice being offered reflects the concerns and pressures now being exerted upon trustees; to ensure successful relationships with their clients, investment professionals should also understand these. The trustee's role has become much more pressured and investment managers would do well to remember this.

Investment is a topic that frightens people who are not familiar with it. At the same time, investment is one of the most important responsibilities of trustees. Put these two together and there is the potential for damaging consequences. This has already been highlighted by the Myners Review of Institutional Investment and also recognised in the Pensions Act 2004. These 10 top tips are intended to help trustees focus on a relatively small number of issues and yet be confident they can do a good job for their members, and meet regulatory requirements.

### 1 Do not make decisions on anything you do not understand

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

A sound working relationship with the employer is crucial, particularly now as many pension funds have significant deficits. The financial

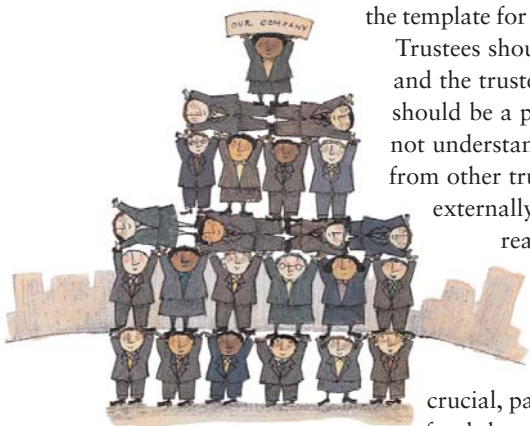


support the employer is willing to give is important, but not as important as the ability to deliver. The pension fund in deficit is an unsecured creditor of the employer, with a long term repayment or funding plan in place. The natural position for the employer is to seek to maximise future returns, 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.

### 3 Know what risks you are taking

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.



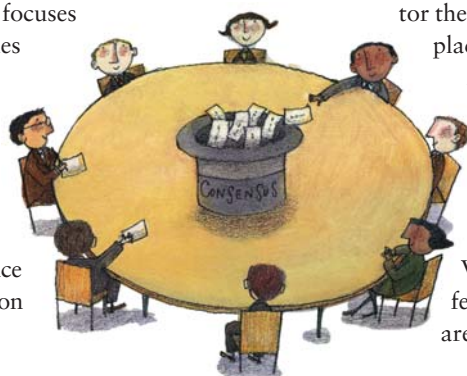
#### 4 Identify and manage conflicts of interest

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.

#### 5 Focus on the Statement of Investment Principles (SIP)

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.

#### 6 Use advisers who will advise you

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.



*Trustees should question and not always accept the advice given...*



#### 7 Insist that investment managers' reports meet your needs

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

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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.



## 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.

## 9 Communicate

*'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 programme'.



These 10 top tips on investment for Trustees have covered a lot of ground but with hardly a mention of Myners. If Trustees follow them, they will be going a long way towards complying with the Myners Principles. ■

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*'The 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](http://www.learnaboutmoney.org)), on CD Rom and in hard copy workbooks.*

