

Tomorrow's Value: Guide for pension fund trustees

Resource and key questions

Introduction

We recognise that pension fund trustees have different levels of fiduciary responsibility and delegation duties, but this is an example of the type of letter and list of areas for discussion which your trustee board or investment committee may wish to use as a starting point when addressing long-term value with your investment consultants and asset managers.

It builds on the 'guide'¹ and the 'agenda for pension fund trustee boards'² and is not designed to be prescriptive, but to give you practical support in framing the discussion with your service providers and testing how they think these matters through.

Developing a new view of value over the long-term as discussed in the guide and agenda will present challenges both to asset owners and to some investment consultants and asset managers. You do not need to be an expert in this area (and indeed neither does your service provider), but are entitled to take the lead on it with your service providers. The process of constructing such a letter, having reflected on the guide and agenda, should enable you to engage more fully on this with them.

Statement of terms

We use a number of terms throughout the guide, agenda and this resource – what we mean by these is as follows:

Fundamental beliefs – trustees should be clear about their fundamental beliefs and what factors they take into account when considering long-term financial objectives and investment related risks

Board mandate – Trustee boards should have a shared clarity of the most fundamental principles of their *own* mandate, which helps them to formalise their strategic intent in relation to values, standards, performance outcomes and key issues of risk and forward development

SIPs – SIPs can, in principle, provide much of this information. However, they may often be completed without the Board being clear about their own mandate

Mandates to suppliers – on the basis of shared clarity about fundamental beliefs, the mandate and SIPs, this will better frame the parameters of the mandates given to their suppliers

¹ Tomorrow's Value: <http://tomorrowcompany.com/tomorrows-value-pension-fund-guide>

² Tomorrow's Value: <http://tomorrowcompany.com/tomorrows-value-pension-fund-agenda>

Tomorrow's Value: Guide for pension fund trustees

Resource and key questions

Draft letter

Dear [investment consultant/asset manager]

We all acknowledge the need for a more constructive dialogue between trustee boards and investment consultants and asset managers when considering risk and receiving clarity around the investment objective which then needs to be delegated through the board executive programme. While having a clear statement of investment principles provides specific guidance, we would like to take this further and ensure that we are communicating our 'fundamental investment beliefs' to enable you to communicate these better with other relevant stakeholders. The purpose of this letter is to then help you understand the context in which the scheme operates and the longer-term values and objectives of the trustee board and its investment committee, so that you are in a position to act accordingly and to bear these in mind when you are [selecting managers/carrying out the trustee board's mandate]. We would therefore encourage you to consider these matters when you engage with asset managers and your investee companies/funds further along the value 'chain'.

We have also set out:

- some features of our governance structure and what we might reasonably expect from each other over the course of the trustee board mandate;
- some questions and areas for discussion – we are not seeking a 'tick-box' checklist response to these but rather to use them to frame these discussions.

These matters are not to be read as having legal force or affecting the formal terms of reference/investment management agreement.

Context

From our perspective, it is best practice for the parts played by investment, funding and the support provided by the [company] (the employer covenant) to be viewed holistically over the life-span of the scheme.³

You should already have copies of [relevant documents provided], notably [the scheme's Statement of Funding/ Investment Principles, funding position...] but this can only inform you about the formal objectives. So, I should like to give you [below/in a meeting] an overview of the history/evolution of the scheme whose members are the fundamental stakeholders for whom we are fiduciaries and the role played by the employer in supporting the scheme [...comment on key characteristics of scheme: open/closed to accrual/to new members], projected maturity and time period over which liabilities of the scheme extend; membership profile, how the scheme came to be supported by the current sponsor group, brief commentary on sponsor, nature of its industry (e.g. mature, cyclical, covenant characteristics)]...

³ [Pension Regulator's Code of Practice on funding defined benefits <http://www.thepensionsregulator.gov.uk/doc-library/codes.aspx> – note revised Code currently under consultation].

Beliefs and objectives

[Overview of the trustees' approach to managing the inter-related range of covenant, funding and investment related risks over different time horizons so as to ensure that their schemes are well funded, not just in the short-term but potentially over several decades to come, though contributions from an employer which can support them and through growth in the scheme assets. The Pensions Regulator now has to incorporate a sustainable growth objective in the way it regulates pensions funding, and we address this in our view]

[Overview of core trustee board beliefs as a way of informing overall financial objectives and approach to 'financial risk'; understanding the way the view of 'value' is reflected in the trustee board mandate to ensure 'long-term value assets'; balancing short and long-term objectives in meeting a long-term financial return]

[Overview of the trustee board's current funding and investment objectives in the SIP, how this has evolved; comment on funding and investment objectives and strategy over different time periods (for instance, whether the scheme is on a planned path towards 'self-sufficiency' or buy-out, and its broad philosophy towards de-risking)]

Governance structure and operation

[Overview of the way in which the trustee board operates – what and how investment, funding and covenant risk are managed and monitored at board and/or sub-committee level; good governance – effective delegation of the pension regulation, ensuring that it is fit for purpose in achieving its duty; terms of reference, membership of committees; trustee risk register and environmental, social and governance (ESG) factors]

[Comment on investment skill sets on investment/trustee board]

What you can expect from us

[Comment on the manager/consultant selection and review process – how often this takes place, what degree of periodic formal and informal engagement and discussion in the intervening periods, degree of interaction with other parties/advisers]

What we will expect from you

[Comment on what the trustees will value from the investment consultant/investment manager (i.e. beyond the narrow performance mandate terms)]

We look forward to discussing the matters further with you etc.

Yours sincerely

.....

Areas for discussion

These areas for discussion are not designed to be exhaustive, but to indicate the areas of focus. We encourage you to develop these based on the attached letter.

Fundamental beliefs

- What do you understand by the terms ‘value’ and ‘long-term’ when selecting managers/investments? Does your interpretation vary according to your specific terms of reference or do you/your firm have a view independent of that?
- ESG and ‘long-term value’ are evolving concepts and firms treat them differently – could you characterise how your firm’s thinking has been evolving in this area and where this should be heading?
- How do you view ‘risk’; in all of this and do you see investment risk as linked to other risks?
- Does your portfolio contain investments in companies that are likely to have stranded assets?⁴ How has that risk been assessed?
- [We have reviewed your firm’s policy on ESG matters – areas for further discussion are...]

Application and promotion of beliefs or concepts

- How do you actually apply your firm’s ESG policy – how does it inform your choice of suppliers such as brokers; proxy voting; manager/investment selection; integration into screening or analysis; risk scenario assessment; reporting to clients?
- Are such matters applied systematically through your firm (tool/data) or are they dependent on individuals?
- Does your firm actively look to promote any aspects of ESG or concepts of long-term value?
- Do you see “long-term value” as equating to a long-term investment holding period?
- Do you consider the holding period as long-term and under what criteria the investments are held? Do you have the same approach with other clients?

General

- Can you identify any areas in the formal terms of reference between us that are potentially problematic or could result in misalignment between our respective beliefs and objectives?
- How do you think we can improve alignment and consistency of approach?

⁴ Stranded assets are those with a value that would change dramatically, either positively or negatively, under certain scenarios such as reasonable price on carbon or water, or improved regulation of labour standards in emerging economies.