SUCCESS through transparency

Aon senior investment consultant, **Betty O'Reilly**, discusses the need for 100% transparency from pension providers, and how this helps to ensure value for money for sponsors and members.

The weight of regulation on pension scheme trustees and sponsors is ever increasing, as more obligations are being placed by the IORP II (Institutions for Occupational Retirement Provision) Directive as well as by the Pensions Authority.

Under the IORP II Directive, trustees will be expected to have clear governance systems in place which ensure proper oversight of all aspects of a pension scheme. In addition, trustees must understand the role of the trustee board, ensure that the composition of the board is fit for purpose, that it meets regularly and that trustees themselves have met fit and proper criteria. "IORP II is the most important development in this area for quite some time", says Betty O'Reilly, senior investment adviser with Aon. "The directive was to have been transposed into Irish law in January but has been delayed. Ireland is among a number of EU countries not to have implemented it yet, but it will have to be enacted by the end of the year."

Unsurprisingly we are now seeing a number of knock-on effects. In some cases, it is resulting in the collectivisation of smaller schemes into master trust structures. This relieves the sponsors of the regulatory burden whilst also offering economies of scale which should deliver better outcomes for members.

Another impact has been an increase in the level of outsourcing of trustee responsibilities. Outsourcing responsibilities presents its own challenges, however, principally in relation to value for money and transparency. "Trustees and finance professionals should be challenging their advisors and providers so that both the scheme and members are getting maximum value for their money with 100% transparency at all times", says

O'Reilly. "It is also very important for members to have relatively easy access to information on their pension scheme. Sponsors and trustees therefore need to exercise the utmost care when selecting an external provider."

This is particularly important when it comes to fiduciary investment management – where the day-to-day investment decision making and implementation of the investment solution are delegated to an expert third party. "Transparency in relation to costs, performance and reporting is absolutely vital in this key area", O'Reilly adds. "The UK enacted IORP II into law last year so we already have some experience of what it means for schemes and how to maximise transparency for trustees and members."

Costs

The devil really is in the detail when it comes to fees and charges. "Fee structures vary from provider to provider and members should be able to see a full breakdown of the fee element, which can include: the provider's fee, investment consultancy fees, the underlying manager fees, and any other administration, custody or fund expenses", O'Reilly advises.

Key questions are: who is being paid for each element, and what are they being paid for? What does the fee to the provider cover? Are there any other additional fees which are not included in the base cost? Are there hidden investment charges?

Other questions she lists include: Does the provider offer their own internal investment funds, external funds or a mixture of both? What fees are associated with them? Does the manager earn money from using in-house funds or do they receive fees from using certain preferred investment managers?

"These are just a few of the questions which must be asked of providers", she notes. "The key question, of course, is if the fees and charges can be justified. And this can only be answered if there is real clarity and transparency."

Performance

This is not just a number and is about a lot more than meeting a certain rate of return or market average. "How to measure the performance of your fiduciary solution provider is one of the more topical areas at present", O'Reilly adds. "In the context of transparency, the important thing is to have a clear benchmark and investment objective that is linked to your particular goals." And these goals will differ from scheme to scheme, particularly so for defined benefit and defined contribution schemes. "A key objective in defined benefit plans is to achieve a certain funding level", she explains. "Strategies should be defined with that in mind."

That should inform the investment strategy in terms of the asset classes and risk profile adopted. The benchmark utilised for measurement has to be appropriate, of course. For defined benefit schemes the liabilities can be the most important benchmark. "It's not just about performance in a particular year", says O'Reilly. "The provider has to demonstrate that they are not taking excessive risk against agreed benchmarks and this should be taken into account when measuring performance."

For defined contribution schemes, the trustees should ensure that the strategy is suitable for the needs of the individual members. "At the very least, the objective should be to preserve the real long-term value of members' investments after inflation and net of charges."

She points out that a very low risk strategy is unlikely to achieve that objective. The same applies if costs are too high. "Members should be aware of the costs and fees associated with the different funds offered", she advises. "The manager might be offering some quite sophisticated funds, but it should be possible for the members to see if the relatively high fees charged can be justified by the potential returns on offer."

Reporting

Interestingly, the IORP II Directive requires benefit statements to contain sufficient information to enable the member to understand the impact of costs on their pension entitlements and to compare pension scheme cost levels. "Members can often find benefit statements difficult to understand", O'Reilly adds. "Trustees have to ensure that the statements are attractive, easy-to-read documents which allow members to find the information they need."

And that applies to the reports received by the trustees from investment managers and other providers. "Reports should be clear, transparent and comprehensive and allow trustees and members to get a good understanding of what is happening under the lid. Any trustee or provider thinking of outsourcing should question the provider on all these aspects."

She highlights five key areas when considering providers of outsourced investment: fees and charges; performance measurement and reporting; risk management; approach to investment and potential for conflict of interest and track record and reputation of the team. "When looking at these things they should ask to speak to existing clients of the provider. The provider should be transparent enough to facilitate that."

"Transparency and success go hand in hand", she concludes. "Trust is central to a successful relationship between pension scheme trustees and investment management and other providers. Full disclosure in relation to fees and charges and performance coupled with clear and accurate reporting provide a solid foundation on which to build that trust. That in turn will facilitate the establishment of a successful long-term partnership between the scheme and the provider."

Transparency is a core value at Aon. "We believe in full transparency and that improving standards across the industry will benefit all stakeholders. Trustees and finance professionals should therefore take every opportunity to challenge their providers and advisers to ensure they are getting the whole picture all of the time."