Dear Members of the Select Committee

We are two UK finance professors who have spent many years analysing UK pension fund investment performance and we would like to alert the House of Commons Select Committee on Work and Pensions Inquiry into the Pension Protection Fund and Pensions Regulator, to two disappointing developments in the reporting of pension fund returns.

First, the UK’s two main pension fund performance measurement services (CAPS/WM) have closed or are closing down, meaning that there will no longer be a peer-group benchmark of defined benefit occupational pension fund returns available in the future. Such a dataset allows for a comparison of the relative performance of an individual pension fund. The absence of such a dataset means that in relation to, say, the pension scheme of BHS, it is not possible to determine how much of BHS’s pension fund deficit is due to underfunding and how much is due to poor investment management decisions.

Second, there is no centralised organisation collecting any data on either the investment strategies or the investment performance of any of the new defined contribution default funds following the start of auto-enrolment. This again means there is no way to assess the relative investment performance of these funds, and hence the effectiveness and value-for-money of auto-enrolment covering nine million new pension scheme members.

In the accompanying note, we expand on these arguments, and also suggest some possible actions that the Select Committee might take.

Yours sincerely

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Written evidence submitted by David Blake and Ian Tonks on behalf of the Pensions Institute

Until recently, there were two major performance measurement services in the UK: CAPS and WM. These two organisations have offered these services to pension funds (particularly Defined Benefit occupational pension funds, of which there are about 6,000 in the UK) over many years (data from CAPS goes back to at least 1984). These performance measurement services collected and collated investment returns from individual pension funds on a regular basis, monitoring the performance of fund managers employed by pension funds, and produced peer-average performance measures that allowed pension fund trustees to assess the performance of their fund manager(s) in relation to the industry average.

Importantly, these pension funds returns are proprietary information. There is no obligation in the UK for an individual pension fund to publicly report its specific investment returns (unlike mutual funds and unit trusts). A pension fund only has to report its performance to its sponsor and members. In such an opaque environment, one can understand why performance measurement services provided a useful service.

Both of these organisations had their origins in groupings of brokers and consulting actuaries, but over time were subsequently re-organized and sold to other financial institutions. Most recently CAPS was owned by Russell-Mellon, and WM owned by State Street.

The business model of these performance management organisations was: a) to be employed by the pension fund and in return to monitor and assess the returns generated by internal and external fund managers of the pension fund’s segregated assets, and b) by offering the same service to many other pension funds, to provide each pension fund with a benchmark performance of all the funds being monitored by the performance management organisation. Both CAPS and WM provided their services to more than 90% of DB pension funds roughly equally distributed between the two services. The two services between them covered almost all UK pension funds over a 30-year period and so generated returns that were devoid of both selection bias and survivor bias. No other country in the world has collected such a unique, valuable and comprehensive database.

Both WM and CAPS have generously provided data on the quarterly returns generated by the sample of pension funds, in an anonymised form for academic and practitioner research. This has resulted in a number of research outputs identifying issues in the performance measurement of pension funds: Brown et al. (1997), Blake et al. (1999), Timmermann and Blake (2005), Tonks (2005), Blake et al. (2013). The UBS Pensions Indicators annual publication, which serves as a reference manual for DB pensions in the UK, makes extensive use of the WM pension returns data.

Unfortunately, these two services are in the process of closing down because of a) the decline and eventual demise of DB plans has seriously reduced WM and CAPS’ revenues and b) because other organisations (e.g. investment banks) have offered performance measurement services for their pension fund clients at lower cost. (From a research point of view this is not useful since the data collected is likely to be subject to both selection bias and survivor bias and so will be nowhere nearly as useful as the WM and CAPS data. In addition, the data is not put into the public domain)
This process began around 2004 when a scheme-specific funding standard was introduced in the UK by the 2004 Pensions Act and pension funds became less interested in peer-group comparisons as they had previously been since the 1970s when performance measurement services were first introduced.

In 2013, CAPS ceased providing performance management services to pension funds, and in July 2016, WM also announced that it was closing down its service. This means that there is no longer a source for obtaining information about the returns to UK DB pension funds, since there is no obligation for pension funds to report this information for regulatory reasons.

We would suggest that there is a wealth of financial performance returns data going back to at least to 1984 that risks being lost.

We believe that these developments are relevant for the House of Commons Select Committee on Work and Pension inquiry into the Pension Protection Fund and Pensions Regulator since the absence of a peer-group benchmark of pension fund returns makes it impossible to assess the relative performance of an individual pension fund. For example in relation to the pension scheme of BHS, unless there is a peer group benchmark of average pension fund returns, it is not possible to assess whether the pension fund deficit of BHS is due to poor fund management decisions or some other reason.

The Pensions Regulator would have a much better idea of the state of the BHS pension scheme, and whether it has been mis-managed, if the data on BHS pension fund returns were publicly available, along with the data on similar pension funds to allow for a meaningful comparison.

Therefore the Select Committee should consider recommending that all DB/DC pension schemes publish financial returns data, and to allow for an historical comparison should suggest that the Pensions Regulator investigate the possibility of obtaining the historic CAPS/WM datasets.

We would suggest that the Select Committee consider the following actions:

1. Recommend that the Pensions Regulator investigate obtaining permission from Russell-Mellon and State Street to access their datasets on the historic investment performance of UK DB pension funds; and
2. Consider changing legislation so that in the future the Pensions Regulator undertakes a quarterly survey to obtain information on investment returns on UK DB pension funds going forward.

A second disappointing development relates to the new world of auto-enrolment in defined contribution schemes and in particular the default funds. There are many large single-employer schemes and over 100 multi-employer schemes in master trusts all of which since October 2012 have to offer default funds. There is no central or regulatory organisation collecting any data on either the investment strategies or the investment performance of any of these default funds. This means that there will be no possibility of unbiased independent research assessing the effectiveness of auto-enrolment covering nine million new pension scheme members.

We would suggest that the Select Committee consider the following action:
3. Consider changing legislation to require all registered default DC pension funds to publish on a quarterly basis:
   a. quarterly asset allocations;
   b. quarterly investment returns in all asset classes;
   c. identity and investment mandates of each fund manager in each asset class; and
   d. identity of investment consultants in each asset class.

This lack of transparency of both DB and DC pension fund returns represents a serious omission in the regulatory framework, and one which has been exacerbated by the withdrawal of the previous performance measurement services.

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References