Research Report on the Effectiveness of Oversight Committees: Decision-Making, Governance, Costs and Charges

Anna Tilba, Michelle Baddeley and Yixi Liao

TABLE OF CONTENTS

EXECUTIVE SUMMARY

As part of the FCA Asset Management Market Study, the FCA commissioned some exploratory academic work to inform its understanding of the dynamics of, and obstacles to, effective investment decision making by oversight committees, with a focus on pension trustees. This report explores investment decision-making in the asset management industry, focusing on the impact of behavioural biases and herding/group-think on investor decision making. It also considers the role played by asymmetric information and principal agent problems in exacerbating some of these problems. The paper also analyses the extent to which qualifications and education help trustees to make better decisions and/or better understand fees and documentation, and includes an assessment of the quality/standard of discussions at oversight committee meetings.

These issues are explored by using the following methodological tools: a review of the academic literature on behavioural biases and corporate governance; an online survey of 71 institutional investors (insurers, charities and pension funds); and in-depth interviews of pension fund trustees and pensions experts. All in all 17 interviews were conducted and 5 additional written responses were received during the fieldwork.

This study identifies a number of inter-linking factors as important challenges to effective investment decision-making by institutional investors. These include: behavioural biases within trustee boards and their members; complex and voluminous information with which the trustees have to work; varying levels of investment knowledge and expertise; opacity of data; lack of ability to challenge consultants' advice and monitor the quality of financial services, as well as various constraints on switching services when needed. These factors are likely to exacerbate problems emerging from asymmetric information - including adverse selection, moral hazard and principal agent problems – especially given the complexity of decision-making structures for institutional investment. In addition, low levels of investment experience by members of oversight committees may also exacerbate these problems. The online survey found that although the majority (69%) consider they have relevant qualifications, a significant proportion considers that they do not (31%).

There is evidence that the incentives of the often large number of agents (asset managers, investment consultants, trustees, employer) involved in overseeing, managing and implementing institutional investment strategies, are not always aligned with those of the underlying beneficiary. For example, this study highlights that investment consultants may have incentives to recommend over-complex strategies or their own asset management products (such as fiduciary management), helping the consultants to generate revenue but not necessarily in the best interests of their clients. In addition, the large number of agents involved in institutional investment can make it difficult for oversight committees effectively to monitor the various agents to ensure value for money for the end investor.

Another inhibitor to effective investment decision-making seems to be the conflict of interest between short-term reporting demands for pension fund trustees versus views about what might be in the long-term best interests of the fund overall, and by extension its investors and/or members. The constraints of so-called ‘quarterly capitalism’ – in which the demands for frequent, short-term performance reviews limit the ability of businesses to take a more far-sighted perspective – are well understood to be counter-productive, but are nonetheless difficult to overcome.

In the in-depth interviews with pension funds, trustees express frustration at being unable to access information about their portfolios, or to negotiate with investment consultants and fund managers who are imposing, what they regard as, unreasonable terms of contracts on them.

The findings from this preliminary work will be considered alongside the evidence collated from other work carried out by the FCA, as part of their asset management market study.

1. INTRODUCTION

This study was commissioned by the Financial Conduct Authority (FCA) to illuminate some of the decision-making processes affecting decision-making on the oversight committees of institutional investment companies. We explore the range of constraints on effective oversight committee decision-making using a range of methodological tools, alongside a multidisciplinary analysis of theoretical insights from information economics, behavioural economics and corporate governance research. Decisions by institutional investors' oversight committees, in common with other types of group decision-making, are affected by social influences. The impact of these social influences will be determined by context and institutional arrangements. Different institutional investors will deal with these constraints in different ways and so we begin our analysis with a description of the background – including some information about the different forms of institutional investment. Once the institutional context has been described, then some key insights from economics about information constraints are analysed alongside a range of behavioural biases relevant to financial decision-making generally and institutional investment specifically.

To explore these ideas, we start with an overview of the institutional investment landscape in Section 2. This provides some context via a brief summary of the structures of some of the key institutional investor groups in the UK. This shows how different institutional investors fit together, describes some key features of the industry and the organizational structures typical for key institutional investors.

Then, in Section 3, we review a range of insights from economics – including information economics, behavioural economics and social economics. We then assess how insights from these literatures might be applied in increasing our understanding of the range of obstacles and challenges facing oversight committees when making their decisions; for example decisions may be distorted by information problems, misaligned incentives; behavioural biases; and social influences. Given the group nature of oversight committees, we will focus particularly closely on the range of social influences that might affect group decision-making – including two key forms of social influence: informational influences and normative influences.

To unravel the extent to which these various factors affect institutional investment decisions, Section 4 presents results from an online survey of trustees on institutional investor oversight committees. This survey was designed to identify a range of potential economic and behavioural influences on the decision-making of trustees on oversight committees. Results from responses from 71 oversight committee members – covering a range of institutional investors including pension funds, insurance firms and charities.

Section 5 provides an overview of the literatures on corporate governance, pension funds, trustee expertise, investment consultants' roles, and information flows to trustees regarding costs and performance information. This literature review focuses on developing our understanding of the key obstacles to effective decision-making by institutional investment oversight committees. In Section 6, some of these insights are applied in a qualitative case study of pension fund trustees. It begins with an overview of the methodology and results from 17 in-depth interviews and 5 comprehensive written responses to the interview questions. The in-depth interviews were used to explore market participants' views about the obstacles that oversight committees face when making investment decisions.

Finally, we present our overall conclusions, outline the key limitations of the findings and explore how institutions' decision-making structures can be re-designed in order to improve the operation of institutional investors' oversight committees, whilst ensuring that their decisions are properly aligned with the long-term interests of the beneficiaries of the funds that they manage.

2. INSTITUTIONAL INVESTMENT IN THE UK

This section provides an overview of the key institutional investor groups in the UK. It shows how the different institutional investors fit together, describes key features of the industry and provides an overview of the organizational structures typical for key institutional investor groups.

At the end of 2014, total assets under management (AUM) in the UK was £6.6 trillion, with two-thirds made up of institutional investors (FCA, 2015). A report published by the OECD (2015) showed that the total financial assets held by insurance corporations and pension funds in the UK accounted for £4.1 trillion in 2014. Essentially, institutional investors are financial entities pooling money to purchase investment assets. Institutional investors in the UK consist mainly of pension funds, insurance companies, endowment funds and sovereign wealth funds.

2.1 Pension funds

Pension funds are a specific focus for this study because they account for the largest proportion of all types of institutional funds in the UK in 2014 (Investment Management Association, 2014). The umbrella bodies for pension funds are the Association of Member Nominated Trustees (AMNT), the Pensions and Lifetime Savings Association (PLSA) and the Local Authority Pension Fund Forum (LAPFF). The UK pension funds originate from a trust tradition, which dates back over 800 years (Blake, 1995). Under Trust Law, pension fund trustees are entrusted with discretionary power to manage the assets for the individuals in their best interests (Blake, 1995; Kakabadse and Kakabadse, 2005; Clark and Urwin, 2008). It should be noted here that local authority pension funds and occupational pension funds are subject to different regulatory pressures in the UK. Occupational pension funds are subject to The Pensions Act (1995; 2004) while local authority pension schemes are regulated by Local Government Scheme Regulations (1998; 2008).

Pension-fund assets are generally managed by asset managers and pension providers, on behalf of firms and their employees. The two broad types of pension schemes are defined benefit (DB) schemes and defined contribution (DC) schemes. The objective of DB pension scheme is to meet future liabilities as they fall due; for defined contribution pension schemes it is to generate steady financial growth in the long run, and ultimately, ideally to offer better pensions for employees after their retirement.

More specifically, DB pension schemes have rules specifying the rate of benefits that will be paid. Unlike DC pension schemes where pension payment is based on investments, the payment of DB pension schemes is based on a number of criteria – promising members a pension based on years in service and earnings, usually final salaries. DC schemes are pension pots that are based on the contribution made by the employee and/ or the employer. Typically, individuals are allowed to choose from a wide range of funds to suit their personal needs.

Over the last decade, final salary DB pension schemes are being replaced by the DC schemes, and this has shifted the burden and risks of financing the scheme on to employees, relative to the DB arrangements in which employers bear the risks of investment. With DC plans, pensions awarded depend entirely on the amount invested and the performance of that investment in the market (Kakabadze and Kakabadze, 2003). Trustees of DC pension schemes tend to provide members with a certain degree of freedom regarding the choice of funds in which to invest.

Most of the pension funds in the UK are established on a trust basis - a board of trustees is responsible for making investment decisions – though the mechanisms for appointing these trustees vary. For all pension schemes where the Member Nominated Trustee rules are applicable, the board of trustees should consist of at least a third member-nominated trustees (MNTs)[1].

Chart 1 gives a summary of various types of pensions offered in the UK pensions market, according to legal, regulatory and market characteristics.

[1] Source: The Pensions Regulator

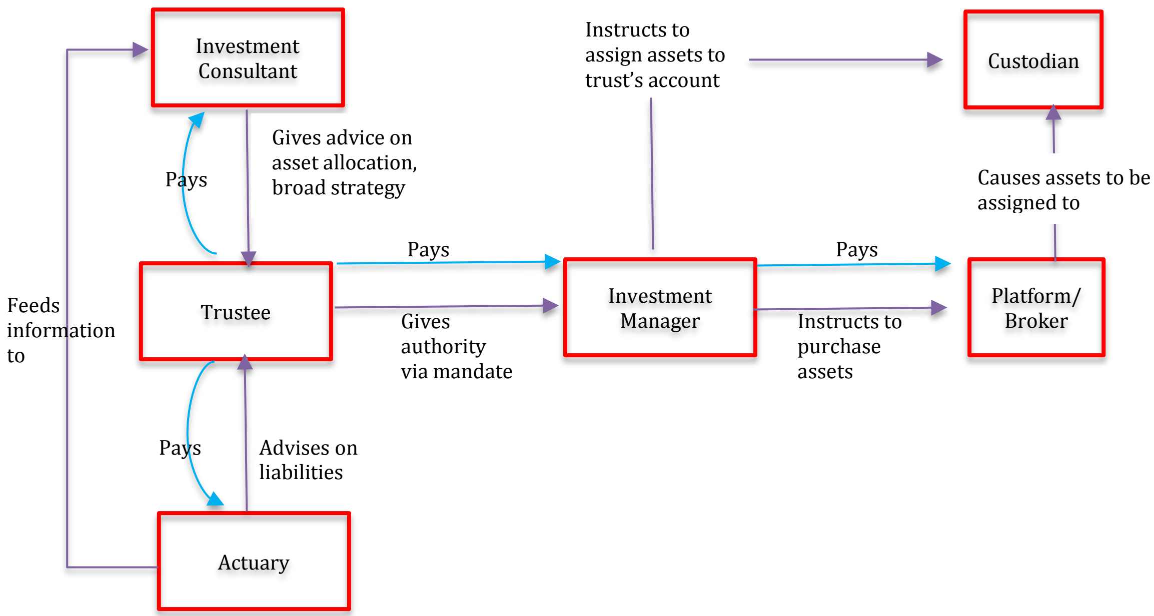
CHART 1 – Types of Pensions Offered in the UK Pension Market

The UK Pension Market				
	Occupational salary related	*Occupational money purchase*	*Group personal or stakeholder pensions*	*Individual personal pensions*
Legal division	Trust-based pensions ("occupational")		Contract-based pensions	
Regulatory division	The Pensions Regulator			
			Financial Conduct Authority	
Market division	Defined Benefit (DB)	Workplace Defined Contribution (DC)		"Private" personal pensions
		Trust-based	Contract-based	

Source: The Law Commission (2014)

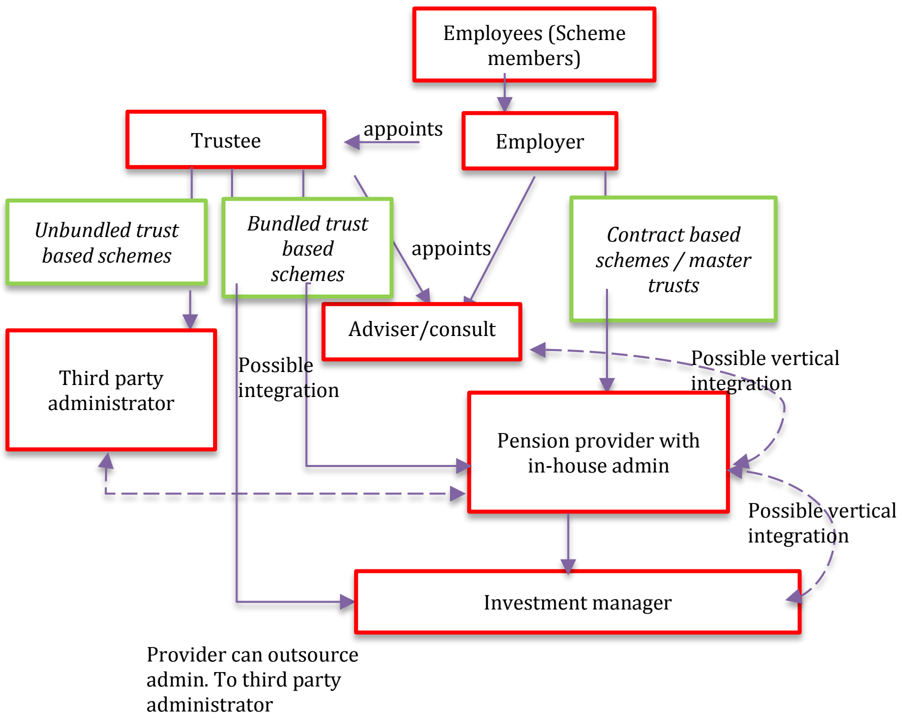
A typical governance structure of a DB-pension scheme and a DC-pension scheme are shown in Chart 2 and 3 respectively. In general, pension schemes' dependence on internal and external expertise varies. Some pension schemes have their own investment management team, whilst others delegate investment advice and asset management to external investment managers or consultants, entirely or partially.

CHART 2 - Typical DB-pension fund governance structure



Source: The Law Commission (2014)

CHART 3 - Typical DC-pension fund governance structure

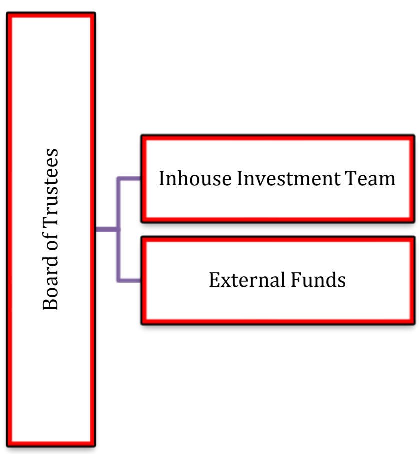


Source: Office of Fair Trading (2013)

2.2 Insurance companies

Insurance companies provide insurance policies either via direct or indirect selling. They account for the second largest percentage share amongst all institutional funds in the UK (Source: Investment Management Association, 2014). The Association of British Insurers is the umbrella body of UK insurance firms. A typical organisational structure of an insurance company is shown in Chart 4.

CHART 4 – Typical Insurance Company governance structure



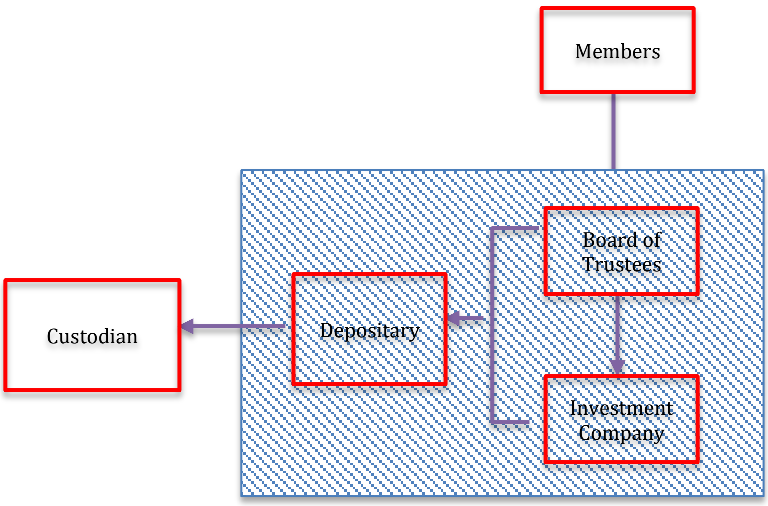
Source: Investment Management Association

2.3 Financial endowment funds

A **financial endowment fund** is often a pool of financial donations given to a non-profitable organization in order to support ongoing business operations – including charities; universities, colleges and schools; and religious organisations. Like all other institutional investors, endowment funds also require a governing board to oversee activities. The trustees have the duty to control and manage the administration of the fund.

An example of an endowment fund is shown in Chart 5. In the example illustrated, the members appoint the board of trustees, which in turn appoints the investment managers for the endowment funds. The board of trustees and the investment company then together appoint the depositary. Following from this, the trustees, the investment company and the depositary together appoint the custodian company.

Chart 5 – Example Endowment Fund governance structure



Source: Investment Management Association

2.4 Implications of organizational structure

Given these different institutional decision-making structures across the different types of institutional investors, it is likely that different institutional investors will conduct and co-ordinate their operations in different ways. For example, on pension funds the participation by lay trustees is likely to be more prevalent, and this may have implications for the extent to which the oversight committees are affected by group influences. The online survey conducted, the results of which are outlined in

Section 3, does identify the different types of institutional investor and ongoing research and analysis of the survey results in future research reports will aim to unravel some of the differentials in styles of decision-making and capabilities for institutional investor trustees.

3 DECISION-MAKING IN THE ASSET MANAGEMENT INDUSTRY

In this section, we set out some key insights from economics generally and behavioural economics specifically that can illuminate our understanding of constraints on effective decision-making by the oversight committees of institutional investors. In understanding when and how oversight committees' decisions might be vulnerable to distortions, there are three overarching, interlocking problems. Firstly, there are institutional failures – not attributable to sole individuals – and these arise because of uncertainty and poor information. A second set of failures emerges from the strategic and self-interested behaviour of individuals who may have incentives to withhold relevant information – linking to problems of asymmetric information and related principal-agent problems. Thirdly, there are individuals' behavioural biases and these may compound the institutional constraints and information problems mentioned above. Finally, behavioural economics and social psychologists have analysed, across a range of contexts, the role of social influences on people's decision-making.

3.1 Information problems

Investment decision-making generally is impaired by imperfect information in a number of ways. Firstly, when information is generally poor quality and/or general uncertainty is endemic, then this will affect everyone equally. Future results and performance will be uncertain and so difficult for *everyone* to predict. Good quality information will be hard for *anyone* to find. More subtle but potentially more serious in the context of institutional investment is the problem of *asymmetric information* – one decision-maker does have some accurate information but they have incentives to conceal their superior information from others. The problem is not of complete ignorance and uncertainty; but rather is about a well-informed decision-maker opportunistically exploiting another person's ignorance – in order to gain some monetary and/or strategic advantage by withholding information from others.

There is a very large literature in economic theory and beyond about the problems associated with the asymmetric distribution of information. Economists have identified two broad types of asymmetric information: adverse selection and moral hazard. *Adverse selection* is a problem that emerges when key attributes of a product are hidden from the buyers, sometimes described as a problem of quality uncertainty. The seminal analysis is an exploration by Nobel Laureate George

Akerlof of the *lemons principle* problem – an analysis of hidden attributes in used car markets (Akerlof 1971). A person wants to buy a used car but has no mechanical knowledge. They go along to a few car yards and try to figure out as best they can which car is most likely to be reliable and good value. But they confront a problem of sellers whose incentives are quite different – the sellers want to sell cars of whatever quality for as much as possible. Akerlof assesses what happens if car yards are filled with a diverse range of cars, and it is hard for buyers to separate the good cars ("peaches") from the bad cars ("lemons"). If buyers are not able to differentiate the quality of these different types of cars, then the sellers of lemons can exploit the buyers by charging the same price that the sellers of peaches are charging.

Assume that the price of used cars in this distorted market reflects average quality of all the cars together – lemons and peaches together. Then, the lemon sellers do well, at least in the short term, but the average quality is pulled down by the presence of lemons in the market, to the detriment of the sellers of peaches. The sellers of the peaches cannot achieve a fair price because the buyers cannot detect the superior quality of the peaches. So the peach sellers start to exit the market. As they withdraw their peaches from sale, average quality deteriorates and the market price falls accordingly. So more peach sellers leave and average quality and price fall again – deterring more peach sellers. Akerlof postulates that, in theory, this process will continue until, at the limit, the market disappears. The poor quality products (the lemons) have driven out the good quality products (the peaches) – this is the adverse selection problem: the market has favoured the poor quality products - the lemons – with adverse implications for trade overall.

What has this to do with institutional investment? There is a direct corollary in financial markets. Amateur investors and lay trustees, for example those who serve on pension fund oversight committees, have no good way of distinguishing good financial investments from bad ones, and even professional trustees might struggle to make these distinctions if costs and charges are opaque and complex. The sellers of higher value products and/or products with lower costs and charges are not able to get a fair price and they will have no incentive to develop better products. Market competition will suffer as a consequence. Adverse selection will be a significant impediment to effective competition in the asset management industry.

Another information problem impeding effective competition in the asset management industry is *moral hazard*. Moral hazard occurs when one party is able to “cheat” by concealing their opportunistic actions from another party. They get away with uncooperative behaviour because observing and monitoring others is often difficult/costly. This is the essence of *principal agent-problems*. A principal hires an agent to perform a task – but because the principal has to exert costly effort to monitor their agents to ensure that they are behaving well, the agent can get away with behaviour that is not in the principal’s interests. The classic example is employer and employee. The employer (the principal) hires an agent (the employee). The employer wants their employee to work hard and to focus 100% of their time and energy to creating value/profits for the employer. But the employer and employee’s incentives are not necessarily closely aligned. The employee may prefer to spend their time chatting with friends, online shopping or checking out Facebook, but perhaps their employer does not have the time or resources properly to monitor this inefficient shirking behaviour. Unless the employer stands over their employee’s shoulder throughout the working day (which would be a very costly and inconvenient exercise), the agent can get away with low levels of effort. They can conceal information about their lack of effort, to the employer’s disadvantage – unless the employer implements some solutions, for example using performance bonuses or share ownership to ensure that the employee’s incentives are more closely aligned with the employer’s incentives.

As for adverse selection, there are important implications of moral hazard for institutional investors’ oversight committees and asset management. In essence, moral hazard reflects conflicts of interest between parties to a contract and this can be a major problem if a fund manager has control over the invested assets by a principal – the trustee and pension fund owners (Fama 1980; Jensen and Meckling 1976). When transactions lack transparency, an agent (e.g. an investment manager) can “cheat” a principal (e.g. lay trustees on oversight committees) by providing poor quality service. Fund managers (the agents) know more about what they are doing than the pension trustees (the principals) and so they are able to take excessive risks, incorporate inadequate precautions and/or charge excessive fees because pension trustees do not have the information to judge whether or not their funds are being managed efficiently. The fund manager is acting opportunistically to the detriment of the principal, and can do this even more easily if the principal does not have the expertise accurately to judge the situation.

Education and training could play a role in ameliorating these information problems because it would be harder for an investment manager opportunistically to conceal information from trustees if trustees are well informed and confident about finance and financial products. With better qualifications and a good financial education, a knowledgeable trustee will be better able to detect opportunistic behaviours and take appropriate action. If trustees are not so well informed, investment consultants may be able to help oversight committees, at least partly, by providing investment expertise to support the effective monitoring of fund managers. But problems may still emerge if moral hazard problems iterate down to investment consultants too. Conflicts of interests may become more complicated if there are several agents involved in a contract. Multiple agency theory captures additional complexity in the nexus of relationships characterising fund management, including when conflicts of interests emerge within more than one agent group and when at least one of those agents is connected to a different principal (Arthurs et. al., 2008), exacerbated ifinvestment consultants may have special relationships with the fund managers.

In the pension funds industry particularly, the corollaries of principal-agent problems can emerge in complex and inter-connected forms. Employees wanting to invest in a pension may have no option but to delegate management of their pension pot to a pension fund, or they may have no choice but to contribute to their workplace pension in the form of contract-based schemes. For occupational trust-based pension schemes, ultimately these employees are the principals and their immediate agents are the pension fund trustees. The pension fund trustees hire their own agents to perform tasks – they want to create assets with lasting value but often they have little expertise in managing assets for themselves. So they hire another set of agents – or in the case of institutional investment – a series of agents including managers and consultants – to manage the fund. So the nexus of principals and agents in the institutional investment industry is complex, and each agent in the chain may have an incentive to prioritise their own interests over those of the principal.

In these circumstances, it is often difficult and costly for the pension fund trustees to monitor their agents' activities, the value of pension pots can be eroded by the agents' conflicting pecuniary interests. Asset managers' charges may be excessive and/or complex. Costs and charges may be difficult for trustees to detect and challenge. To redress the balance, there may be ways to design incentive structures to ensure more effective alignment of the interests of the pension fund's principals versus agents. For boards composed mainly of member-nominated trustees, incentives between trustees and pension holders may be more closely aligned – with trustees more likely to focus on the investor outcomes for pension fund members. Also, the behaviour by agents may be less aligned with the end investors on boards comprised solely of, for example, employer-nominated trustees. In this case, trustees may be more likely to focus on the firm's benefits by acting to minimise contributions by the firm, which may not be in the best interests of pension holders.

The pension funds industry specifically has flagged some of the problems that can emerge if there is not sufficient diversity. At a roundtable attended by pension fund representatives and hosted in summer 2016 by the *Engaged Investor* trade magazine, diversity was flagged-up as one of the major concerns by pension-fund representatives, alongside lack of education and training. For the pension fund industry at least, incentives for participation as a trustee are limited. Barriers to participation are high and include significant time commitments in attending and preparing for board meetings, persuading employers to give potential trustees permission to attend, lack of financial incentives – especially for those who have to take unpaid leave and/or incur travel expenses to attend. Specific concerns were raised at this roundtable about the absence of relatively young people and women.

3.2 Incentives and Motivation

Alongside the analysis of information problems, this report also explores the role played by diverse incentives and motivations - beyond purely monetary motivations. Economists traditionally assume that our incentives are financial/monetary – but behavioural economists explore a range of other motivations too, including intrinsic motivations (e.g. enjoying a job, taking pride in your work etc.) as well as extrinsic motivations (e.g. earning a salary, social approval). To what extent are the members of oversight committees motivated purely by monetary incentives? To what extent do other non-monetary, social motivations play a role (e.g. wanting to contribute to fair transparent pensions, increasing the chances of a prosperous retirement for members and/or effective and fair governance of a stable financial system)? If decision-makers are motivated by non-monetary motivations and a desire to serve the public good, then problems of asymmetric information and related principal-agent problems are less likely to be serious.

3.3 Behavioural economics – general principles

The information problems described in section 3.1 above are not inconsistent with highly rational forms of decision-making, such as those usually associated with standard economic and financial theories, which assume that decision-makers are objective and rational, using all the information they have in a systematic and accurate way. The origins of these insights come from the *rational expectations hypothesis*, originally attributed to Muth (1961) and the cornerstone of modern macroeconomic theory and policy. According to the rational expectations hypothesis, decision makers make complete use of all available information, respond instantaneously to new information and do not make systematic mistakes.

Behavioural economists challenge this stark description of behaviour, arguing that cognitive limits and information problems constrain perfectly rational decision-making (Simon 1955). Also, people may use their capacity for rational decision-making selectively – sometimes thinking carefully but other times deciding more impulsively, either to economise on the time and effort involved with deep thinking or for psychological and emotional reasons (Leibenstein 1950, 1976).

3.3.1 Heuristics and bias

Probably the most influential set of challenges to the standard economic view of rationality emerged from seminal research papers by Daniel Kahneman and Amos Tversky, who developed alternative analyses of how people choose and decide.[2] Tverky and Kahneman (1974) explain how many common mistakes we make emerge from the use of heuristics – the quick decision-making short cuts that we all use when we do not have the time, energy or cognitive power to think deeply about our decisions and choices. Whilst heuristics are often sensible decision-making tools, they can also be associated with a range of systematic decision-making biases that distort objective decision-making.

Some examples of biases relevant to financial decision-making include loss aversion, endowment effects and optimism bias. With *loss aversion*, we care more about losing money than we do about winning it. Endowment effects emerge when we over-value things we already own it and under-value things that others own.

[2] For some of the seminal accounts, see Kahneman (2011), Thaler (2015), Thaler and Sunstein (2008); Ariely (2008) for a very readable popular account; and Baddeley (2013, 2016) for surveys of the literatures.

So the amount an individual is willing to accept when selling something is greater than their willingness to pay for something they do not already own, even for identical items. With optimism bias, we over-estimate the likelihood of winning, and underestimate the likelihood of losing. Our responses to choice and information are also associated with less than perfect decision-making: behavioural economists have used experiments to show that when we are exposed to too much choice or too much information, that is when we are facing *choice overload* and/or *information overload*, our performance may be impaired. This illustrates a key distinction between behavioural economics and standard economics, because standard economic policy prescriptions would generally advocate more information and more choice as good things. In the context of institutional investment decision-making, if trustees are exposed to a wide range of complex investment products and services, the range and complexity of choices may impair effective decision-making.

There are many more potential biases distorting our financial decision-making and the literature and lists of potential biases are vast and unstructured. Kahneman and Tversky (1974) focus their analysis on explaining biases emerging from the application of three broad types of heuristic: availability, representativeness, and anchoring/adjustment. When we over-weight information that is accessible and easy to remember we are applying an *availability heuristic*, and this makes us more prone to making decisions on the basis of more memorable information – including recent events and/or vivid, emotive information. When we draw, sometimes false, analogies with superficially similar events and scenarios, we are using the *representativeness heuristic*. When we adjust our judgements around old, inaccurate information and/or reference points determined by social information about others' decisions, then we are using the *anchoring/adjustment heuristic*. It is important to emphasise that using these heuristics do not necessarily imply that the resulting decisions are stupid and irrational – boundedly rational decisions, including decisions driven by heuristics, may be relatively sensible even if they are associated with systematic mistakes and behavioural biases. Sometimes it would be more foolish to spend a lot of time thinking about a decision with relatively trivial consequences.

The anchoring/adjustment heuristic also links to Kahneman and Tversky's *prospect theory* (e.g. see Kahneman and Tversky 1979). Prospect theory provides and alternative to standard economic models with its focus on reference dependence, loss aversion and unstable risk preferences, and it has been widely applied in behavioural finance. Loomes and Sugden's alternative analysis of decision-making under uncertainty – *regret theory* – captures how people's perceptions of the impacts of events on themselves will shift with different states of the world. Another key theme of relevance in behavioural finance is the literature on behavioural discount functions – which capture present bias and short-termism.[3]

The impact of emotions on decision-making deserves a special mention, and is highlighted in the related literature on "systems" decision-making, recently popularised in Kahneman (2011). Analyses from neuroscience and neuroeconomics provide experimental evidence about the balancing of reason and emotion in the context of economic and financial decision-making, and this links to analyses from Daniel Kahneman and others about how decisions are driven by interactions between System 1 fast, intuitive thinking versus System 2 slower, more deliberative thinking.[4]

3.3.2 Behavioural bias – insights for investment and finance

In applying some of these insights to institutional investment specifically, there is a large and related literature in behavioural finance about key forms of behavioural bias, specifically applied to financial investment. Key themes in this literature are financial distortions caused by bias, for example the equity premium puzzle, home bias and over-confidence.

The *equity premium puzzle* is a behavioural anomaly observed when financial markets do not arbitrage away consistent excess returns on stocks versus bonds. Bernatzi and Thaler (1995) explain this as a function of traders' myopic loss aversion – traders are simultaneously excessively focused both on the short-term and on avoiding losses. Ephemeral short-term fluctuations in share prices distract them from taking a long-term view of investment performance. Bernatzi and Thaler argue that traders are not taking advantage of potential profits from investing in shares over bonds because they are disproportionately pre-occupied with losing out from short-term stock markets falls and so exhibit a systematic bias against investing in these assets.

[3] See Laibson (1997) for an analysis of present bias in the context of "quasi-hyperbolic" discounting. See also Frederick et al. (2002) for a survey of different models of shifting time preference from behavioural economics.
[4] See Baddeley (2010) for a survey of emotional influences, especially in the context of herding behaviours.

Another bias that has received a lot of attention in the behavioural finance literature and that is relevant to institutional investors is *home bias*. Home bias is a behavioural bias observed when investors prefer investing in assets with which they are more familiar, for example domestic equities. A report published by Vanguard in 2014 identified US mutual funds that allocated just 27% of their investments to funds outside the US (Vanguard, 2014). This can limit portfolio diversification. However, international sovereign wealth funds (SWFs) may be less prone to home bias, as part of their investment strategy is to ensure foreign investment allocation.

Overconfidence is a behavioural bias that could be particularly relevant for institutional investment. It occurs when oversight committee members are overconfident about their knowledge and skills – either ignoring crucial relevant evidence important to effective investment decision-making and/or discounting information that does not support their pre-conceptions. Overconfident committee members may also be more likely to persuade other members to take up their opinions. A lack of knowledge on trustee boards can allow for over-confidence to go unchallenged. Individual differences play a role in bias and over-confidence is one bias that is affected by individual differences. Barber and Odean (2001a) present evidence suggesting that males are more likely to be overconfident than females. Given that a large proportion of pension scheme trustees are male (*Engaged Investor*, 2013), then it could be the case that male-dominated pension scheme boards are more likely to be prone to biases from over-confidence than boards with a more diverse membership. Increasing diversity on boards is one way to mitigage the effects of biases that might emerge as a consequence. Overconfidence may have implications for investment decisions, with the full implications or risks of a particular decision not being given sufficient careful consideration.

The equity premium puzzle, home bias and over-confidence will all compromise investment performance and the decisions of trustees for institutional investor funds. These biases could affect all trustees and their advisors equally and without anyone consciously realizing that they are susceptible. Unlike the information problems outlined above, these biases are not about rational investment managers and consultants deliberately exploiting trustees' ignorance and inexperience, though information asymmetries will potentially compound these problems. If demonstrably systemic, these biases will lead to persistent under-performance by institutional investors, including poor decision-making on asset allocation, risk management, investment timescale, trading frequency and fund style.

3.4 Group decision-making: herding and groupthink

One key focus in our study is on the group decision-making within institutional investors' oversight committees, and also the advice fed into committee deliberations, for example from investment consultants. Social constraints on decision-making parallel insights from behavioural economics about heuristics and bias, but emerge from distinct literatures from economics, economic psychology and social psychology.

3.4.1 Herding and groupthink

Given numerous and complex interactions between different people, social influences and group dynamics are likely to play a significant role in driving herding and groupthink. *Herding* has many, complex definitions across a range of research disciplines and here our definition is simplified to capture imitation of others' choices and decisions. Herding can be loosely categorised as a *herding heuristic*, built around copying others. If we think that others are better informed than us, then it makes sense for us to follow them. *Groupthink* captures the convergence of individuals' judgements when deciding they are deciding within a group – perhaps reflecting socio-psychological influences such as peer pressure and obedience to authority. In explaining these group dynamics, there are key differences across economics versus social psychology around what underlies the decision-making – and the distinctions between the different social influences can be separated into informational influences and normative influences.[5]

3.4.2 Informational influence

The interpretation adopted in economic theory is that herding reflects a rational process of learning from social information. *Informational influence* emerges when people acquire information by observing others around them. Social influences driven by a learning process are not necessarily biases as such because they may reflect a rational process of social learning from observing others' behaviour. Social learning is not irrational when information is scarce and/or a decision-maker has limited prior

[5] Experiments have been used to unravel the differential impacts of informational social influences from normative social influences. Examples include an analysis of housing valuation decisions and jury deliberations (Baddeley 2016*b*; Baddeley and Parkinson 2012).

experience. In these cases, others' actions can be genuinely informative. The problem is that it is difficult to judge when the group is right, and when it is wrong – and when the group is wrong these types of social influences will have particularly powerful distorting impacts.

Economic analyses of this rational social learning process include Banerjee (1992), Bikhchandani et al. (1992). Banerjee (1992) illustrates the mechanisms using the everyday example of restaurant choice. If we see a very crowded restaurant next to a completely empty restaurant, we can reasonably assume that there's something wrong with the latter and we come to this conclusion just by observing others' choices. More generally, we use social information to update our judgements about the likelihood of various scenarios, for example the range of possibilities for the performance of different assets. Bikhchandani et al. (1992) describe this process as an *information cascade* – social information cascades through the group, causing a series of decision-makers to change their minds. The information cascade hypothesis has been widely tested across a range of experimental studies, pioneered by Anderson and Holt (1996, 1997) and generally this experimental evidence shows that people's choices are broadly consistent with a rational social learning process. Anderson and Holt's experimental findings have been replicated across a wide range of studies – but without addressing other potential explanations beyond a rational Bayesian learning process.

Copying others in this way, whilst not strictly irrational, can create problems – specifically *negative herding externalities*. When people are led into a choice that contradicts their private information then anyone watching them will be unable to observe the private information that they are balancing with the social information. The value of information that people have acquired privately will be lost as the information cascade unfolds.

A key implication of information cascades is that differences in people's judgement of the chances of different events are not necessarily the result of individual differences in demographic characteristics and personality traits, but may instead reflect differences in private versus social information. If an individual comes from a position of relative ignorance or inexperience, then they may rationally decide to use social information to guide their decisions, assuming that others have better information. For them, information about others' actions is especially helpful when making a decision.

3.4.3 Wisdom of Crowds

Another set of insights, similar to the information cascades models, is the idea of wisdom of crowds, which is about the power in collective decision-making. Groups of people together, under certain conditions, are more likely to be right than individuals alone. The basis for this idea is *Condorcet's jury principle*.[6] If we pool judgements of a group of individuals, and each individual has a slightly better chance than average of being correct, then the group opinion is significantly more likely to be reliable. The problem for the wisdom of crowds postulate is that it depends on assumption that everyone is deciding independently, and the judgements of the individuals constituting the group are uncorrelated initially. For institutional investment oversight committees, and for financial services generally, this assumption is problematic – as the global financial crisis of 2007/08 illustrated amply. Individual judgements are often highly correlated in financial markets.

3.4.4 Normative influence

Normative influence is about social pressures to conform to a group's decisions and these normative influences are explored comprehensively in social psychology and sociology literatures. We are excessively persuaded by consensus opinions, especially when we are unsure ourselves. We might be too influenced by an authoritarian or seemingly authoritative member of a group. Many experimental studies have shown that people, including experts, are disproportionately affected by groupthink. The influence of peer pressure will be distortionary when there is no substantive basis for such convergence in opinions. These social, collective biases are not necessarily attributable to one individual but have the capacity to compound the problems created by information problems, institutional failures and behavioural bias.

The literature on normative influence is diverse, and contrasts significantly with standard economic approaches to decision-making, which revolve around an individual agent, acting independently and selfishly – without much reference to others. One of the early research studies to show the power of social influences, including obedience to authority, was Stanley Milgram's electric shock experiments. People were prepared to administer what they believed to be life-threatening levels of electric shocks to others because they were instructed to do so by an authority figure (Milgram 1963). Similarly, social psychologist Solomon Asch analysed peer pressure

[6] See Suroweicki (2004) for a readable introduction to this literature.

and groupthink using his “line experiments” –which showed that people were likely to choose obviously wrong answers in a simple task focussed around judging the length of lines (Asch 1955, 1956). Why? Experimental participants were manipulated by deliberately false judgements from the rest of the group (who were being instructed by the experimenters to lie) into making mistakes themselves, even with the very unambiguous line tasks. This finding that has been replicated in a large number of experimental studies and captures the impact of social influence on decision-making.

3.4.5 Herding and Groupthink in institutional investment

What are the implications of these social influences for institutional investment? There is evidence that herding behaviours affect asset allocation decisions generally. Gümbel (2005) observed that UK investors *herd* in their asset allocation decisions in favour of a particular asset class, despite the presence of a more profitable alternative because another manager is trading in that asset class. Wylie (2005) characterizes this behaviour as either buy-herding or sell-herding, which affects pension fund asset allocation and the make up of the pension fund investment portfolio.

More specifically, members of institutional investment oversight committees, as for any other groups of decision-makers, are susceptible to herding and groupthink. Group decision-making biases are likely to have power in some institutional investment contexts, particularly for decision-makers who do not have deep financial knowledge and expertise. In the asset management industry, there is significant variability in the extent to which decisions are taken by individuals independently, versus as part of a group. For some pension funds, group decisions will dominate for example when taken as a consequence of a consensus formed by oversight committees. The problems and biases in asset management and/or purchasing decisions might be more likely to emerge when decisions are made collectively by boards of trustees, in particular when lay trustees without a deep knowledge of different financial products and/or how financial markets work are strongly represented on an oversight committee

Other social influences in institutional investment contexts will affect the process of selecting a fund manager via a beauty parade. For example, on any oversight committee selecting a fund manager there may be a number of lay trustees who do not have deep financial knowledge of the financial industry. They may be easily persuaded by technical, esoteric information even when they do not understand it properly. And even if they are well informed, their choices may be distorted by the group, or may reflect a social learning process, as described above. For example, an oversight committee might be tasked to make a group decision about selecting an asset manager – Asset Manager A versus Asset Manager B. Assume each committee member is relatively well informed and competent. They do some homework. They find some information and apply their own judgement – for example, they may do a web search and find some information about each of the asset managers from online sources. They read this information carefully and come to a private judgement about which asset manager to hire – they decide on Asset Manager B. Then, however, they observe the voting pattern within an oversight committee. Others in the committee are voting in a different direction – to hire Asset Manager A. The committee members will balance their private information against what they observe in terms of others deciding. Then they may change their minds and follow others in selecting Asset Manager A, in spite of a lot of private information they have found indicating that B is better. The problem intensifies from the second committee member onwards, because that marks the point at which subsequent private information is discounted, even though it may be useful. Once the second person has gone down the wrong route, then there is an increasingly large probability chance that the rest of the herd will follow – and a series of committee members, eventually to majority, will choose Asset Manager A. From an individual's perspective, this is not an irrational decision; they may be balancing different pieces of information in a systematic way. The social versus private information that they have acquired is valid but, in balancing the private versus social information, decisions about others' actions may have more weight, especially for lay trustees who may, reasonably, not have deep confidence in their own judgments.

Another interpretation of these behaviours is that they reflect peer pressure – people want to agree with the group. This has relevance to institutional investment because a range of social influences are likely to lead different group members to agree with others, sometimes in ways contrary to their private judgements. This is highly relevant for institutional investor oversight committee decision-making. Meetings are conducted in an open setting without anonymous voting. Committee members may have other professional relationships and so arguing with a chair or other influential authority figure may incur reputational damage, with potential knock-on effects down the line in terms of future job prospects. For oversight committee members with less expertise and knowledge, it may be easy to persuade them of the benefits of one option (e.g. a particular asset manager in a beauty parade) because their private judgements, even if correct and insightful, are easy to challenge and over-turn. On the other hand, the group may have too much confidence in itself and a belief in its own efficacy, even when that belief might be misplaced. We found some evidence for this and other biases and behavioural distortions in our survey, as explained in more detail in section 4.

To summarise the implications for asset management and oversight committee decision-making: as explained above, social influences, including herding, have leverage when oversight committee members' rationality is bounded by constraints in information-processing ability, memory lapses and other cognitive constraints. Then implementation of a herding heuristic will lead decision-makers into following the actions of other members even when others are wrong. In a committee-driven decision making process, groupthink can also reflect less benign influences. Trustees may imitate other members to protect their reputation. In addition, trustees may imitate other members as they give priority to sustaining harmony of the board above critical assessment of individual investment decisions. For reviewing the effectiveness of oversight committees, understanding the different reasons why people agree with others is a crucial issue. If oversight committees form a rational consensus via a process of social learning from others' expertise and experience, this is not undesirable. If, however, members of oversight committees are agreeing because of peer pressure – especially from others on the committee with strong personalities, or because they don't want to disagree with an authority figure then this is a worrying problem.

3.5 Behavioural public policy: using nudges

Insights from behavioural economics and finance have attracted the interest of policy-makers. Possibly the most influential book in showing how insights from behavioural economics can be applied in policy-making is Richard Thaler and Cass Sunstein's (2008) *Nudge – Improving Decisions about Health, Wealth and Happiness*. *Nudge* focuses on the structure of human decision-making – what Thaler and Sunstein call our *choice architecture*, and how it can be leveraged to encourage more effective decision-making – without constraining freedom to choose. The Institute for Government and the Cabinet Office (2010) adapted these ideas for policy-makers in *MINDSPACE* – an influential report in UK public policy-making circles. Behavioural economic principles are also highlighted in a range of reports from individual government agencies – for example the Competition and Markets Authority (CMA), Ofgem, the Department for Energy and Climate Change, the Office for Fair Trading, etc. have drawn on these ideas.

For the FCA, behavioural principles have been applied to financial policy initiatives by Erta, Hunt, Iscenko and Brambley (2013) who present a policy-maker's introduction to the literature on behavioural bias – explaining how financial behaviour can be explained by reference to psychological as well as economic insights. Individuals will make mistakes and regulation is needed to moderate and ameliorate the impact of these mistakes. Most of Erta et al's analysis applies to individual consumers of financial products, particularly individuals made more vulnerable by their limited financial literacy. For institutional investment trustees, it is possible that levels of financial literacy are higher, for example if trustees are self-selecting into investment oversight roles because of their interests and background in finance and investment. Nonetheless the key policy insights about the need for regulatory framework that allows for behavioural bias will apply.

In unravelling some of these influences, in the next chapter we present some survey evidence to assess the extent to which information problems, heuristics and bias, and social influences are affecting decision-making on institutional investors' oversight committees.

4. OVERSIGHT COMMITTEE DECISION-MAKING SURVEY

In the previous sections we have outlined some characteristics of the structure of institutional investors and analysed some of the economic and socio-psychological factors affecting decision-making by trustees on institutional investors' oversight committees. In this section, we outline some results from an online survey of these trustees, representing a selection of pension funds, insurance firms and charities/endowment funds.

4.1 Survey design and distribution[7]

Following from the key themes identified in the literature, as outlined in Section 5, the online survey questionnaire was designed to identify a range of potential economic, behavioural and psychological influences on group decision-making within institutional investors' oversight committees. The survey was distributed to trustees from as wide a range of institutional investors as feasible given the short time frame and limited resources. It is important to note that pension fund trustees were strongly represented in the survey and the extent to which the findings can be generalised to institutional investors more broadly may be limited.

The survey was distributed online in May to July 2016, using Survey Monkey, to a sample of potential respondents from Association of Member Nominated Trustees, alongside some respondents from the FCA's wider market study and members of the Transparency Taskforce for pension funds. The respondents identified via the FCA included those who indicated, in their response to an earlier online survey circulated by the FCA, that they would be willing to participate in a further academic study.

4.2 Profile of respondents

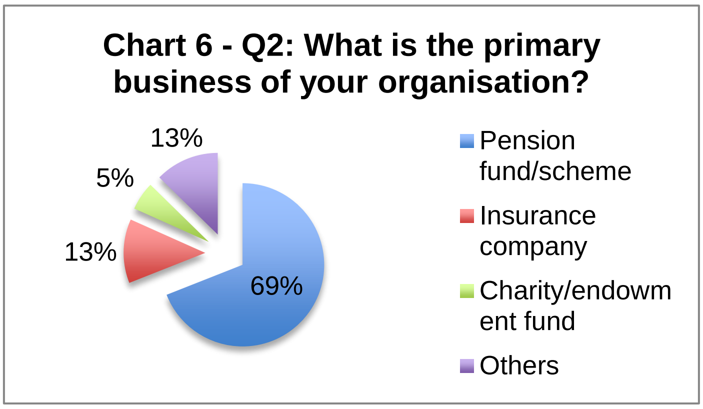
In total there were 71 respondents, 34 of whom were recruited via the FCA, as explained above. From the responses received, not all respondents gave detailed information about their affiliations and activities but of the respondents who did provide this information, most were from a range of defined contribution (DC) and defined benefit (DB) pension funds. Across the different institutional investment types, larger funds were disproportionately represented and so the findings described below may not be easily extrapolated to smaller funds. Institutional investors who were not representing pension funds, insurance companies and pension funds were not well represented, and given the different decision-making and institutional

[7] See Appendix 1 for a copy of the survey questionnaire.

arrangements affecting these institutional investors, the survey results can only accurately describe the former groups.

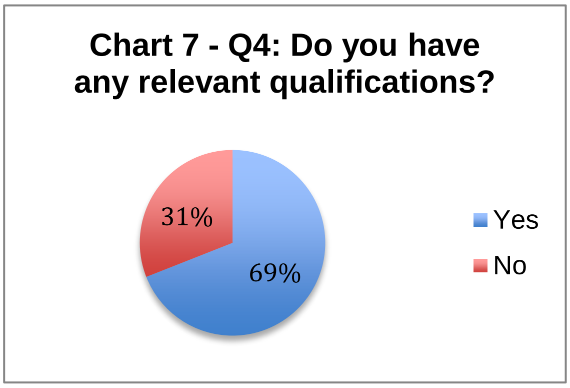
4.3 Survey findings

Chart 6 confirms that pension funds were the largest group of respondents, with insurance companies and charities comprising other significant respondents. The category of "other" captures a relatively large number of respondents who were not representing pension funds, insurance companies or charity/endowment funds.

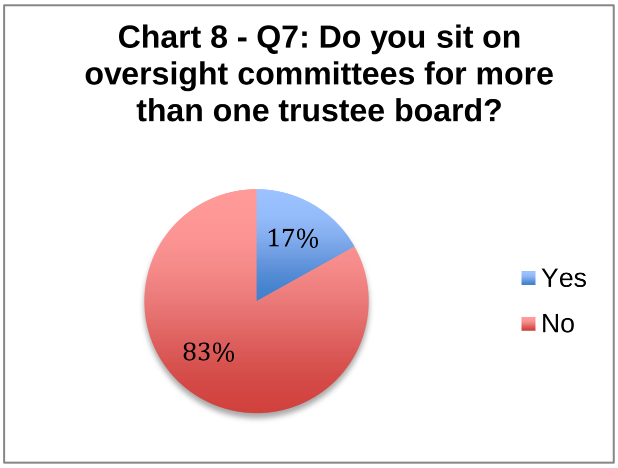


4.3.1 Characteristics of trustees

Other questions explored some of the respondents' roles. Most of the respondents are ordinary members of their oversight committees, that is members without specific *ex officio* roles, including members who were not responsible for chairing their oversight committee. Chart 7 shows the spread of responses to a question about whether or not they have relevant qualifications. Although the majority (69%) consider they have relevant qualifications, a significant proportion considers that they do not (31%).

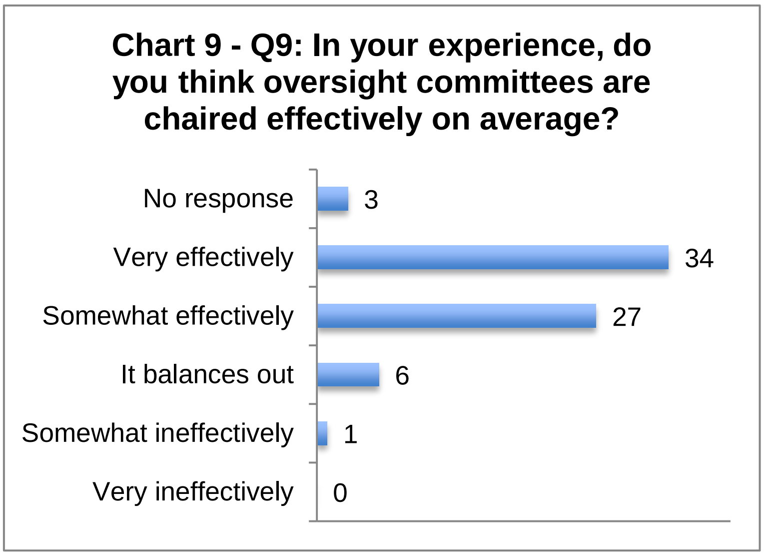


Many of the respondents appear to have significant years of experience sitting on trustee boards, ranging from 11 to 39 years, but Chart 8 shows that most respondents sit on only one board.

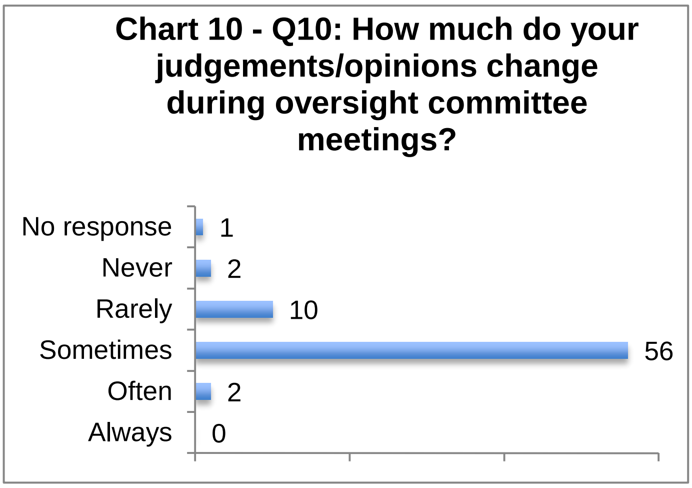


4.3.2 Effectiveness of meetings and deliberations

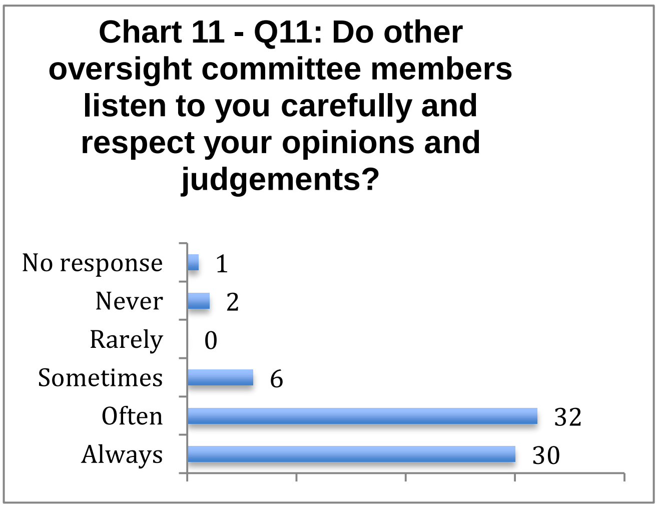
In terms of committee meetings, the range in frequency of meetings is large, but the modal frequency is once per quarter. For the chairing of meetings, most respondents were positive, with a large majority of respondents agreeing that meetings were chaired “somewhat effectively”: to “very effectively” – see Chart 9. This conflicts with insights gathered in the interview stage (described in section 6) identifying a number of concerns about the effectiveness of oversight committee decision-making. This could reflect a problem of over-confidence or it could be driven by the different samples that provide the basis for these separate pieces of research.



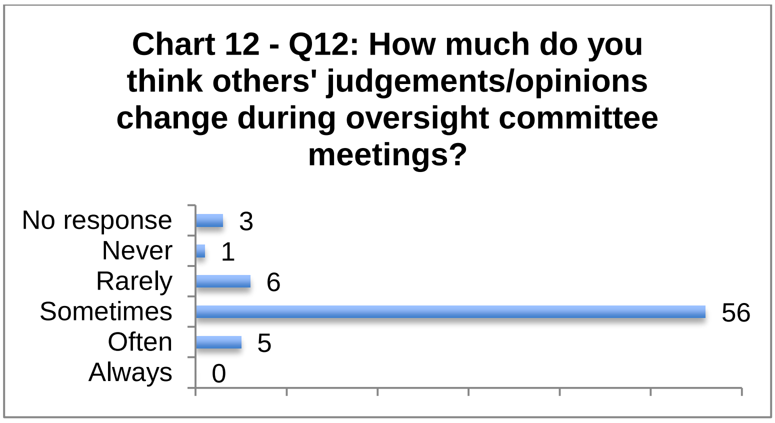
As shown in Chart 10, most respondents claimed that sometimes their judgements changed, and sometimes not – suggesting that they were not adopting a stubborn or over-confident position and were prepared to change their minds depending on the evidence and/or the progress of deliberations.



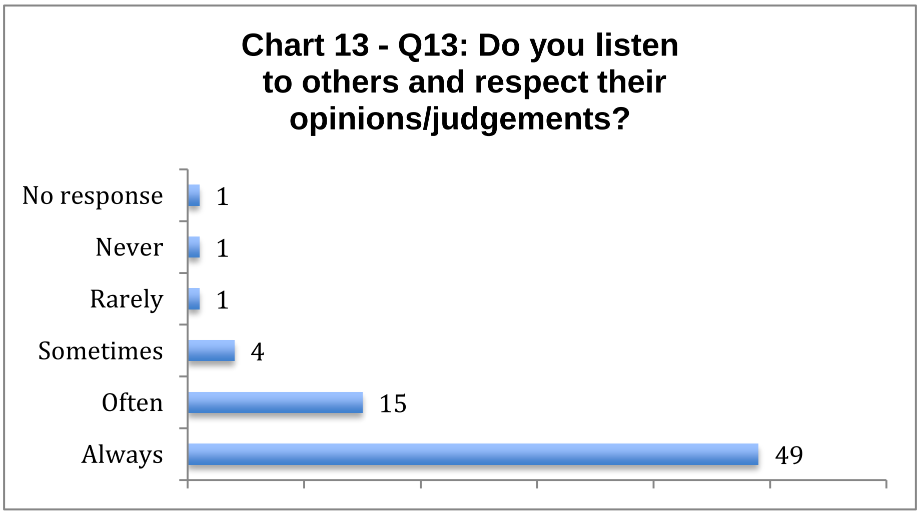
Respondents also felt that others were listening to them on committees – and were reassured that their opinions and judgements were respected “often” or “always” – see Chart 11.



The perception of respondents about others’ decisions relative to their own were similar, with respondents saying that others’ decisions were also likely to change sometimes – see Chart 12.



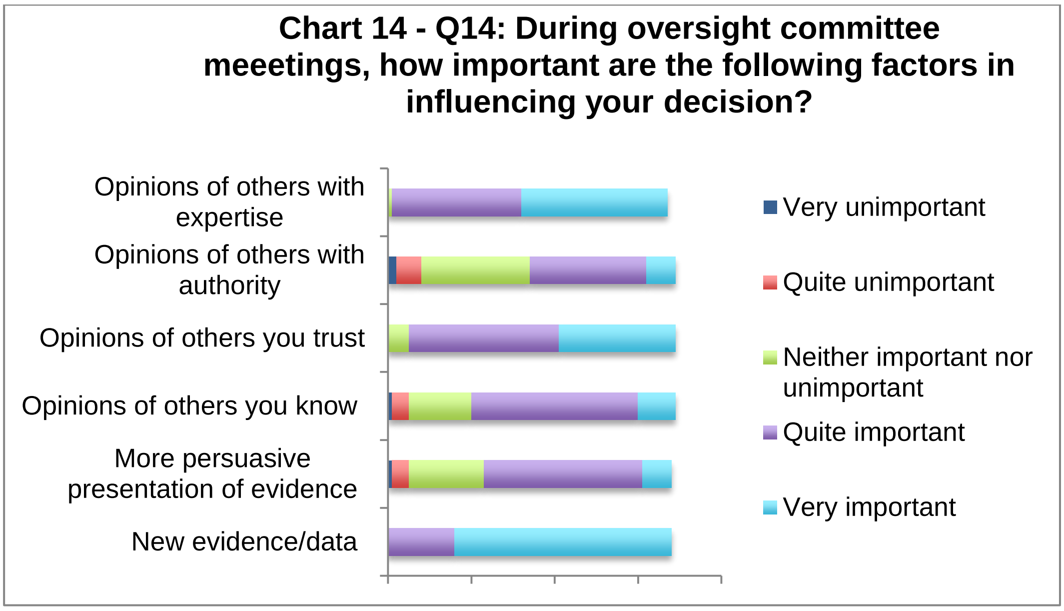
Similarly, individual respondents felt that they respected others' opinions and judgements, just as others respected their opinions and judgements - see Chart 13.



Overall these findings are reassuring in suggesting that most respondents felt that oversight committees were chaired well, with an atmosphere of mutual respect and a willingness to change position if the evidence suggested it would be justifiable to do so.

4.3.3 Key influences on decisions

Chart 14 shows responses to the questions about the influence of various factors on the respondents' decisions when taking part in oversight committee decision-making. Respondents reported that they took the opinions of others with expertise much more seriously than those with authority. They also took opinions of others they trusted more seriously than opinions of people they know. These responses are again reassuring in suggesting that respondents are quite careful in their approach to committee decision-making. The most important influence of all was "new evidence" – again reassuring.



As shown in Chart 15, perceptions of influences on others were similar to influences on their own decisions, though they were less sure that others took new evidence and data as seriously as they did themselves.

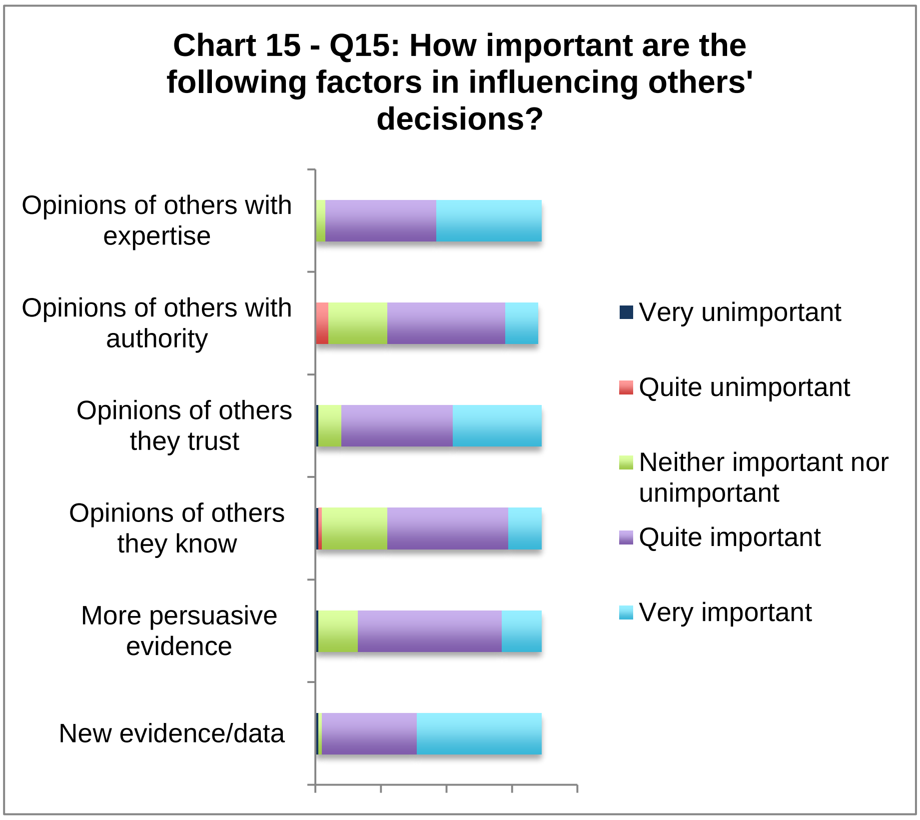
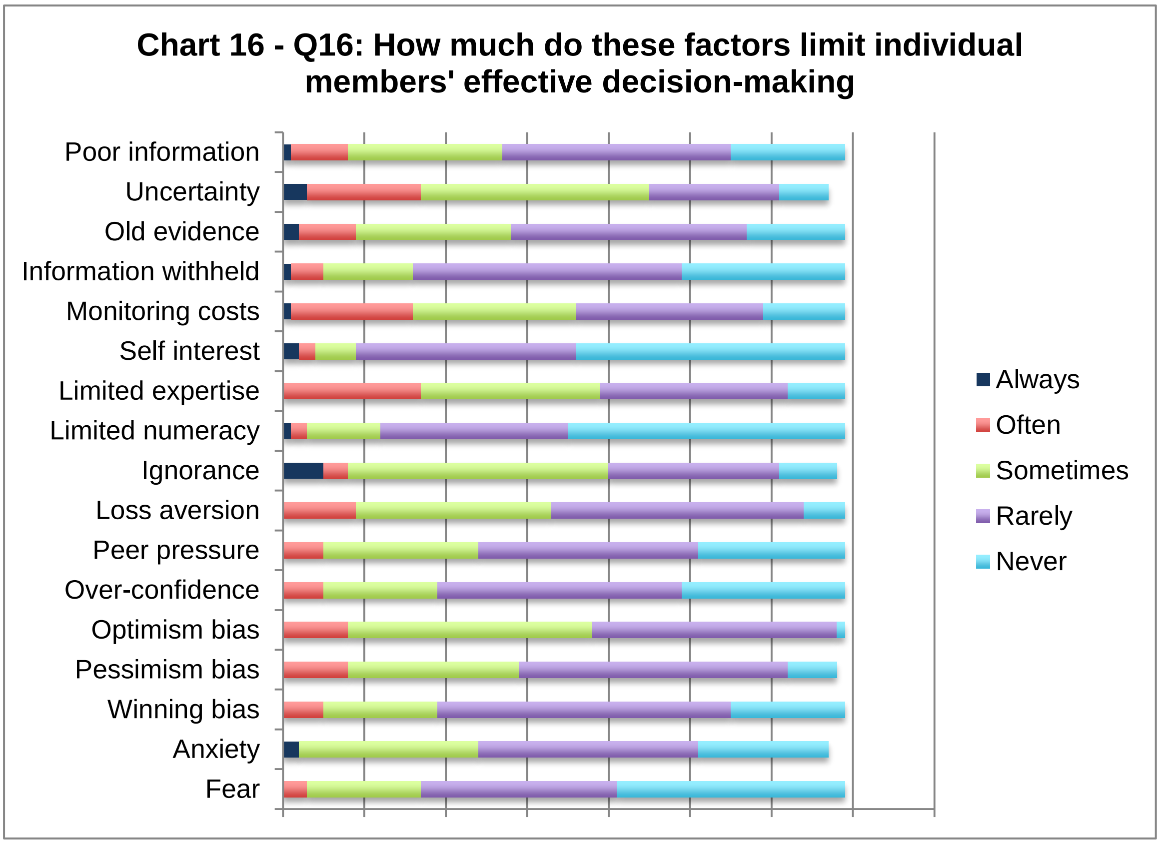


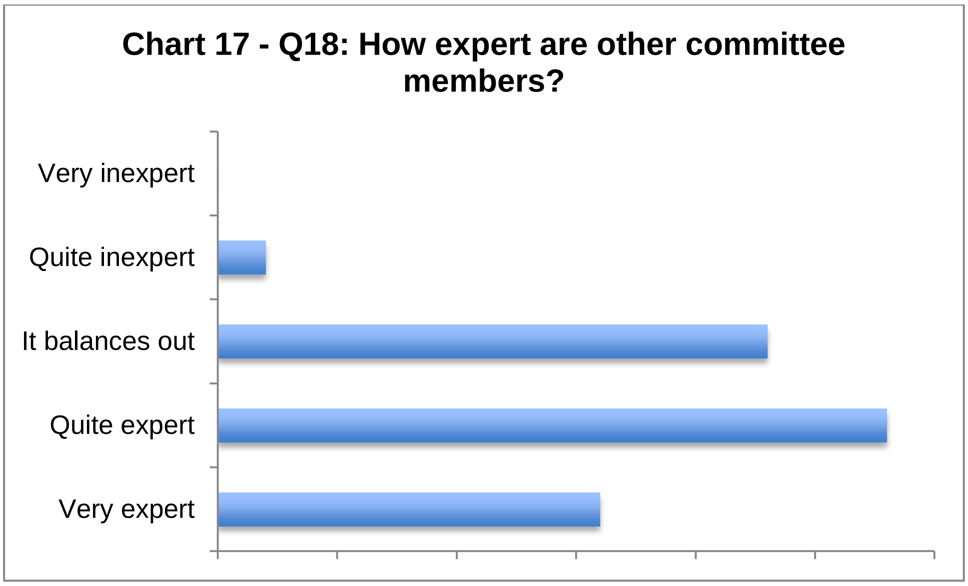
Chart 16 captures the answers to questions about respondents' perceptions of the limiting factors overall. Reassuringly, the proportion of respondents that identified limiting factors was low. Those factors that were identified as more likely to limit individual members' ability to make effective decisions relative to the other factors listed, included uncertainty; poor information; judgements made on old information; limited financial expertise across committee members; and monitoring costs ,



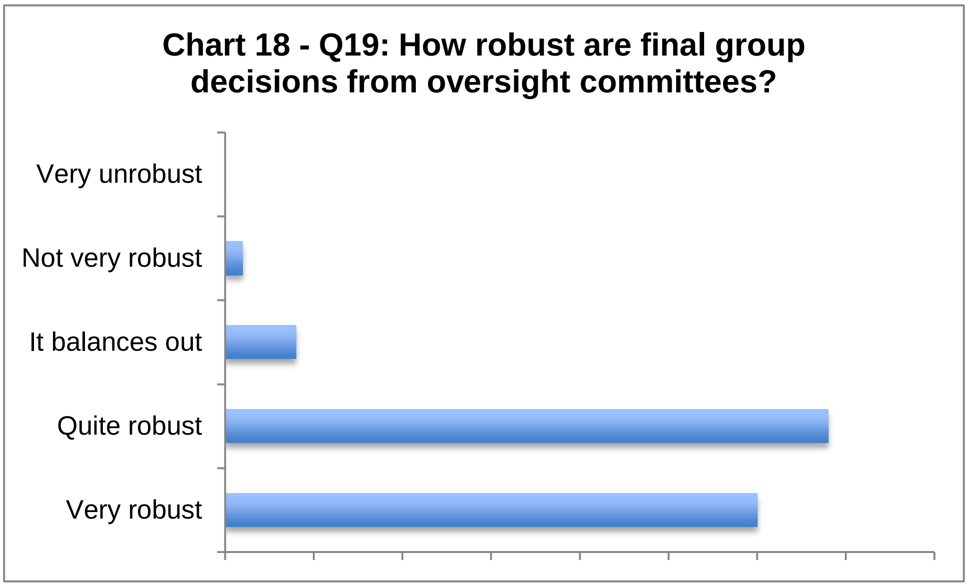
In the free-text, open-ended sections of the questions – a range of other influences were also identified. These included over-reliance on professional advisors, over-reactions to world events (e.g. Brexit) and other exogenous factors beyond any individual's control, which might nonetheless adversely impact on confidence and uninformed views. Pressure from sponsors and advisors, differing preferences for taking risks, institutional and regulatory constraints and changes, "staleness", time and information overload, as well as too much concern about needing external reassurances were also identified as potential constraints.

4.3.4 Attitudes towards other committee members and final decisions

Generally, the respondents were also positive about the expertise of other committee members, with only a few respondents saying that others were "quite inexpert", and no respondents saying that they were "very inexpert" – see Chart 17.



Overall, participants in this survey were confident that the decisions reached on their oversight committees were "quite robust" to "very robust" – see Chart 18.



4.3.5 Discussion of survey findings

Overall, the respondents to this survey were positive about the decision-making processes on the oversight committees on which they serve. They felt that they and their colleagues deliberated carefully and were prepared to change their minds. They thought that most trustees had some relevant expertise and listened to others' positions carefully and respectfully. The key constraints on effective decision-making seemed mainly to be concentrated on factors connected with uncertainty and unclear information – problems that are widely identified in standard economic and financial theory. Factors commonly identified in behavioral economics as biasing decision-making did not emerge as significant influences in this survey. This may reflect the fact that, in contrast to the range of factors identified by Erta et al. (2013) in their FCA paper on consumer bias in the context of financial decision-making, trustees on oversight committees do have better levels of experience and education in relevant areas. Also, people with higher levels of financial numeracy may self-select into these types of roles. Another possibility, however, is that these responses reflect an over-confidence in the group and a misplaced belief in the objective decision-making processes of others.

Alongside uncertainty, judgements based on old evidence were identified as a key constraint. Respondents also identified limited financial expertise across committee members as a key constraint. Themes linked to asymmetric information and monitoring problems were another key influence – with respondents ranking monitoring problems relatively highly. Social influences played a strong role. The influence of others in a group varied according to the individual decision-makers' perception of them. Respondents claim to be more influenced by those with expertise than those in authority. Those whom they trust have a middling level of influence. But it was not clear from the responses how individuals decide whom they do and do not trust. Of the behavioral biases assessed in the survey, a disproportionate emphasis on loss is the most important – which is consistent with loss aversion, a key bias often identified in the behavioural economics literature. Loss aversion is also commonly identified in behavioural finance as being associated with a reluctance to realize losses on assets that are under-performing – which will have key implications for institutional investment.

Overall, the survey respondents identified some limits on effective decision-making, reflecting economic, informational and psychological influences, but generally respondents did think that decision-making on oversight committees was robust. There are key limitations, however, commonly associated with the types of online survey we are implementing here. The extent to which the respondents' answers are accurate and/or honest may be limited, and self-report bias is a common problem in opinion surveys.

To further unravel the influences on oversight committee deliberations, a series of one-on-one interviews of pension fund trustees were conducted to get information about the deeper processes at work – to complement the breadth but more superficial responses from the online survey, and these findings are outlined in Section 6. These interviews revealed some mixed evidence about respondents' confidence in decision-making processes – interview respondents expressed more scepticism about the effectiveness and impartiality of oversight committee decision-making. One explanation for the differences in the perceptions captured in the online survey versus interviews is that the online survey was picking-up a degree of over-confidence relative to the one-on-one interview responses, or that the one-on-one interviews were picking-up a degree of, perhaps misplaced, cynicism about the decision-making process.

5. GOVERNANCE AND OVERSIGHT: THE CASE OF PENSION FUNDS

The online survey analysed the decision-making by a variety of trustees across the community of UK institutional investors. The group most strongly represented in this survey was pension funds and for an initial in-depth analysis of the decision-making styles and procedures, we selected the pension fund industry for an exploratory case study. The other reason for choosing the pension fund industry is that it is engaged in promoting an effective and efficient industry. It is also a more cohesive community than other institutional investors, and in terms of the value of assets under management, is the largest set of institutional investors in the UK.

To set the context for the analysis of the one-on-one interviews of pension fund trustees outlined in Section 6, this section provides an overview of some of the specific background for pension funds - focussing on literatures analysing corporate governance in the context of pension funds; trustee expertise; the role of investment consultants; and costs/ performance information available to trustees. Key themes will be outlined to support our understanding of whether there are any key obstacles to oversight committees making effective investment-decisions.

The well-publicized corporate failures such as Enron, Parmalat, Quest, Tyco and WorldCom have triggered important new empirical and more conceptual research in the field of corporate governance as well as string of policy reports and codes of best practice for UK corporations. A significant amount of research has accumulated in recent years particularly on the oversight role of corporate boards and their fiduciary duty to act in the best interest of shareholders. Prior studies in corporate governance also documented the importance of such characteristics as independence, accuracy, transparency, accountability, experience and knowledge within corporate boards as well as appropriate recruitment, composition and size, succession planning and frequency of meetings for effective oversight and decision-making (Klein, 2002; Weiss, 2003; Uzun, et. al. 2004; Gaynor, et. al. 2006; Adams and Ferreira, 2007, Rose and Rose, 2008).

For example, Vera-Muñoz (2005) suggests that characteristics of effective oversight involve financial literacy, general understanding of company's major economic, operating and financial risks as well as board's broad awareness of the interrelationships of organisational operations, the ability to formulate and ask probing questions of financial reporting. Another study into better board processes by

Finkelstein and Mooney (2003) suggests 5 critical goals for which all boards should strive. These include [1] engaging in a constructive conflict (especially with the CEO) but at the same time [2] avoiding destructive conflict (i.e. avoiding personal and emotional considerations gaining prominence); [3] working together as a team (particularly on complex and ambiguous strategic decisions); [4] knowing the appropriate level of strategic involvement (identifying what is ‘major’ strategic decision); and [5] addressing decisions comprehensively (i.e. looking at an issue or a decision in sufficient depth). These goals also involve getting the ‘right people’ onto the board, creating meaningful structures and setting the stage and steering board meetings. In short, the authors highlight the significance of board processes as well as structures when it comes to improving board effectiveness. Most recently, Buse et al. (2016) have studied a sample of 1,456 non-profit board chief executive officers and found that board governance practices are directly influenced by the gender and racial diversity of the board. The authors suggest that board governance can be improved with more diverse board membership as long as the board behaves inclusively and there are policies and practices in place to allow the diverse members to have an impact. All these characteristics can also be applicable and helpful for pension fund trustee boards. However, it is unclear how trustees take these practices forward and whether all of these steps are implemented effectively. Pension fund governance and effectiveness of trustee board decision-making is yet to generate the kind of attention that corporate boards do. The scarcity of empirical research into effective pension fund oversight to date leaves a considerable knowledge gap, which this report aims to contribute to.

5.1 Pension Fund Trustee Boards

The few academic studies that focus on UK pension fund governance by Clark (2004), Clark, et. al. (2006), Clark, et. al. (2007), Clark and Urwin (2008) and Tilba and McNulty (2013) all identify pension fund trustees as the key group of actors within pension fund investment practice. Historically, a pension fund trustee’s role has been to make strategic decisions while exercising their own judgement and discretion, acting in good faith and in the best interest of the pension fund beneficiaries (Pensions Law Review Committee, 1993).

Lay trustees, including people with various sets of skills, expertise and from different backgrounds and walks of life, now sit on most pension fund trustee boards. A qualitative study on the roles and contributions of UK pension fund trustees by

Kakabadze at al. (2003) indicates that the trustee role is geared towards strategic decision-making for investment management purposes and includes the following areas:

- Setting the mission for the fund and establishing appropriate governance processes and procedures (mission and governance)
- Strategic asset allocation
- Being proactive in fund manager selection
- Monitoring the performance of the fund and its fund managers
- Determining the management structure of the fund
- Determining the parameters of the risk budget
- Designing the performance benchmarks against which the fund is to be compared.

Clark and Urwin (2008) point out that trustees are involved in setting the overall objectives and goals of the pension fund, decide on the specifics of the investment strategy, make operational, monitoring and tactical decisions in response to anticipated and unanticipated events. Clark and Urwin note that while making these decisions trustees are affected by time, expertise, training and collective commitment.

Occupational trustee boards are composed of several different types of trustees. The Pensions Regulator (2010) characterizes these types of trustees as the following:

- Individual trustees typically operate within a group of trustees responsible for running the scheme
- Corporate trustees are elected from the employer's side and has the same responsibilities as an individual trustee
- Nominated trustees are nominated by active and pensioner members of the scheme
- Volunteer trustees will often be members of the scheme and/or employees of the sponsoring company, or both.
- Professional trustees are hired from professional trustee companies and are paid for their services.

One of the very few and most recent studies into pension fund boards by Chen, et. al. (2015) highlights that investment management is viewed as the most important responsibility of the pension fund board, where some pension schemes have a separate investment committee which are also responsible for hiring and firing financial experts or money managers. Those experts are usually required to submit performance reports to the board. Chen et al. (2015) provide an overview of prior studies, which suggest that pension fund board governance could make a significant difference in the selection of investment experts and portfolios, which would eventually affect the investment returns. However, no concrete empirical results in testing these effects were found. Similarly, the authors find mixed results for the effects of trustee board composition on pension fund funding. On the one hand, there is evidence to suggest that having more elected members on the board (either retirees or active members) lowered the funding rates (Yang and Mitchell, 2005). On the other hand, Harper (2008) found a positive correlation between funding levels and the representation of employees on the board.

Gregory (2011) emphasises that board effectiveness and administration receive relatively little attention from trustees, compared to other trustee responsibilities such as investment and funding. Gregory (2011) emphasizes that errors of board judgement and maladministration can damage scheme, employer and trustee reputation. Furthermore, trustee errors can be very costly to resolve and involve significant efforts from trustees, lawyers, and other advisers. These observations are even more pertinent as the Pensions Regulator (TPR) has been given a statutory objective to promote and improve board effectiveness and trustee's ability to oversee administration more effectively. Among things like compliance, good administration also ought to involve good value for money to both trustee and sponsoring employer; effective communication between trustees and the employer; better understanding of the operational risks; having business continuity arrangements in place; keeping board skills reviewed and up to date; and monitoring of the overall effectiveness of the board (Gregory, 2011).

5.2 Trustee Expertise

The level of trustees' investment expertise and influence has been a source of governmental concern for quite some time (Myners Report, 2001; HM Treasury, 2004; NAPF, 2007; HM Treasury, 2008) highlighting the need to challenge more the consultant's recommendations to ensure investment decision-making is in the interests of the pension fund beneficiaries.

The latest report by the UK Law Commission into fiduciary duties of investment intermediaries (2014) suggests some improvement in trustee understanding of investment issues but also notes that trustees are still lacking the expertise to effectively allocate and manage investments or challenge the recommendations of other experts. Although pension fund trustees are not required by common law to be investment professionals, they nevertheless have to operate and make decisions in an increasingly complex world of new financial instruments and financial market intermediaries. The conditions of the current financial markets require trustees to have a level of expertise that is domain-specific and which goes beyond just being conversant with the practice of investment.

Clark et al. (2006) have studied problem solving capabilities of UK pension fund trustees and found these capabilities ‘surprisingly heterogeneous’, with potentially significant implications for pension fund governance. Clark, et. al. (2006), argue that because of their ‘lay’ backgrounds, many pension fund trustees tend to be over-reliant on the leadership qualities and skills of trustee board chairs and/or other external experts. Clark and Urwin (2008) find that only 10% of pension fund trustees think that their colleagues had sufficient investment training. Furthermore, Clark and Urwin suggest that a lack of investment expertise forces trustees to settle on the simplest issues or let those board members with strongly-held views influence the decisions, which are then based on poorly-reasoned conclusions. Similarly, Cocco and Volpin (2007) highlight that occupational pension fund trustees are subject to a number of strong influences, be it from the strong-willed and/or more experienced board members or the CEOs of the corporate sponsor.

Tilba (2011) also notes that there are differences in the levels of investment expertise between local authority and occupational pension fund boards, with occupational pension funds having better finance and investment skills on board. Occupational pension fund trustee boards are more stable, with trustees serving there sometimes for ten to fifteen years. Thus occupational trustees are able to accumulate a more in-depth knowledge of the scheme’s culture, history and its funding needs. On the other hand, local authority pension fund boards are more volatile because, in comparison with the time served by trustees, the tenure of a Councillor depends on the duration of his or her political appointment.

Blake (2003) and Tilba and McNulty (2013) elaborate on a hierarchy of relationships between pension funds, investment advisors and actuaries, noting an interesting problem: on the one hand, trustees have the legal power to decide a pension fund’s investment strategy and how investments are to be managed. On the other hand, the expression of trustee power is limited by trustees’ lack of investment knowledge relative to other actors. Namely, investment consultants have been having significant influence on pension fund trustees' strategic investment decision-making. It will be interesting to explore these issues also considering the wider context of oversight committees.

5.3 The Role of the Investment Consultant

Investment consultants are important intermediaries in institutional asset management, particular pension funds. Many retirement plans use various consultancy services, which include asset/liability modelling, strategic asset allocation, benchmark selection, fund manager selection, and performance monitoring. In the UK, pension fund trustees must "obtain and consider the written advice of a person who is reasonably believed by the trustees to be qualified by his ability in, and practical experience of, financial matters and to have the appropriate knowledge and experience of the management of investments" (The Occupational Pension Schemes (Investment) Regulations 2005, regulation 2(2a)).

The literature about investment consultants is very scarce because consultants have disclosed too little data to allow rigorous analysis of their activities (Jenkinson et. al., 2016).

Another study by the Securities Exchange Commission has looked into the potential conflicts of interest facing investment consultants (SEC 2005). While this report did not find definite evidence that consultants skew their recommendations in favour of certain asset managers, it does note the failure of consultants to disclose the potential conflicts of interest they may have.

Most recently using survey data on investment consultants who advise pension funds on how to invest funds totalling around $25 trillion worldwide, Jenkinson (2013) finds that consultants' recommendations of funds are driven largely by soft factors, rather than the funds' past performance, suggesting that consultants' recommendations do not merely represent a return-chasing strategy. Significantly for this study, the authors also find that consultants are more likely to recommend higher fee products, and that larger products attract more recommendations. The authors found no evidence that consultants' recommendations add value, suggesting that the search for winners, encouraged and guided by investment consultants, is fruitless. In the U.K., a consultation on the fiduciary duties of investment intermediaries has considered whether the role and regulation of investment consultants needs to be reviewed (U.K. Law Commission (2013). The UK Law Commissions' Final Report

(2014) acknowledged that the lack of regulation of investment consultants does appear anomalous, and have asked that the Government actively monitor this area.

Tilba and McNulty (2013) find that trustees' lack of investment expertise, their reliance on investment consultants and their perception of consultants' recommendations as *'endorsing'* in this way, have serious implications for pension fund investment strategy, such as investing equity allocations via active investment fund managers, and focusing fund mandates on producing short-term investment returns. In other words, there is some preliminary empirical evidence indicating that consultants' recommendations appear to be associated with group consensus amongst pension fund trustees.

5.4 Pension Fund Investment Management

Pension fund assets can be managed in three ways: in-house/self-managed schemes, insured schemes and externally managed schemes. The self-managed pension funds usually have an investment team in-house who reports to the trustees but who broadly take the responsibility for asset allocation, investment fund manager selection and investment portfolio management. The insured schemes are usually offered as a contract to clients by life assurance companies, so that the life insurance company does the managing of the assets.

In the externally managed schemes, most of investment management is delegated to external investment experts and managers. The increasing diversity and sophistication of pension fund asset management suggests a broad impression of pension fund organizations 'outsourcing' and an increasing dependence of pension funds on specialist advisers. In this context, those providing the assets and funds for investments must rely on self-interested agents to identify investment opportunities and provide information on expected returns. As a result, the quality of asset allocation depends on how effective the decision process is in reducing agency problems and bringing forth accurate information (Mario and Matsusaka, 2005).

Most UK pension funds delegate their investment management to a multiplicity of external asset management houses, where the investment power is partially or wholly delegated to the external investment managers (Faccio and Lasfer, 2000; Cox, et. al. (2007; Tilba and McNulty, 2013). Often pension funds allocate 'pots' of assets between different asset classes and external asset managers. In a study of pension fund investment practices, Tilba (2011) identifies common patterns of actions and interactions that are taking place within pension funds investment practices across all funds. These common actions are part of a strategic investment planning cycle, which takes place every three years within the legal framework of the Pensions Act 2004.

Overall, the work within Defined Benefit pension schemes' Strategic Investment Planning Cycle consists of trustees obtaining the actuarial valuations of pension fund liabilities and establishing the funding requirements for the scheme; making strategic decisions about the asset allocation and fund manager appointments; and contracting the external investment managers to run the investments on pension fund's behalf. These tasks are captured in Figure 1. Tilba (2011) finds that in order to carry out these tasks, the majority of pension funds rely on other experts because of the increasing complexity of the investment issues and the lack of investment expertise. Most notably, these external experts are the actuaries, the investment consultants, and the investment managers.

Figure 1 The DB Schemes' Strategic Investment Planning Cycle

Tilba (2011) defines the fund manager's mandate as a set of 'strategic parameters' specifying what a fund manager's responsibilities are in relation to that particular pot of pension fund investment, and what a manager is expected to achieve by way of producing returns on that investment. In the case of segregated mandates, the mandate typically includes specific investment benchmarks that a fund manager is expected to meet and better still, outperform. In the case of pension funds, the multiplicity of financial advisors and investment experts means more opacity and layers of different agents' interests and information asymmetries that pension fund trustees and oversight committees have to deal with.

Interestingly, Del Guercio and Tkac (2002) have highlighted that pension funds are preoccupied with their fund managers 'beating the benchmark' because it serves to validate the manager's competence to a trustee committee. They conclude that the shape of the flow-performance relationship in the investment fund industry implies that the winner takes all in this segment and that fund managers are implicitly incentivised to alter the risk of their portfolios to increase the chances of them being among the winners.

Similarly, Cox, et. al. (2007) find that increasing rivalry among fund managers for pension fund contracts encourages a fund manager to focus on short-term financial returns. Associated with these observations, there has been a trend in most stock markets towards the increase in stock turnover and shorter average stock holding periods (Tomorrow's Owners, 2008). Cross Asset Research conducted by Societe Generale (2008) shows that the average period of holding stock on the New York Stock Exchange (NYSE) was just 7 months. In the UK, the average duration of equity holding has fallen from five years in 1960s to just over 7 months (Haldane, 2010). Similarly, a recent survey of a sample of 401 US and UK listed companies from 1985 to 2004 by Haldane and Davies (2011) found that long-term cash flows were heavily discounted and that the tendency to discount future cash flows more heavily was gaining pace.

Georgy (2011) identifies seven common steps for effective outsourcing process:

1. Appointing a working group or sub-committee to oversee the process. The group (usually of around 6 people) ought to represent the interests of the members, the employers and the day-to-day pensions management team.

2. Project planning: the key objectives, the selection process and the key success factors.
3. Examining the market and deciding on a list of providers to be invited to tender.
4. Issuing a request for information (RFI) or invitation to tender (ITT). Once the short list of potential partners is designed, trustees should expect more comprehensive and extensive proposals.
5. Managing and evaluating the tendering process and tenders. Tender evaluation is often done by the working group and often facilitated by an independent advisor.
6. Reviewing the contract and conducting due diligence. Standard contractual terms vary significantly between providers. It is essential that trustees obtain legal advice to make sure that the legal terms are fair and properly describe and support the intended business relationship.
7. Implementation. Trustees need to ensure that appropriate resources are available for project implementation.

It is still unclear to what extent trustees follow these steps and processes in practice.

5.5 Pension Fund Investment Costs and Performance

Retirement income depends on accumulated contributions and the fees that are charged by the pension providers and/or financial intermediaries. Pension funds around the world have suffered from the credit crisis, low stock returns, low interest rates and increasing human longevity. An increase in human longevity by two years had increased UK pension schemes' liabilities by around £51.4 billion, or 5.2% of liabilities (The Purple Book, 2009). In 2014 total UK pension fund liabilities stood at £1,176.8 billion (The Purple Book, 2014). The significant increase in liabilities increases the costs associated with maintaining pension schemes. However, despite the fact that persistent inefficiencies in pension fund governance are eroding future retirement incomes, operating costs of pension funds draw little attention (Bikker, 2013). Hazenberg (2016) highlights that investment fund manager and investor relationships are beset by principal-agent problems described in section 3, particularly in respect to fees. The author questions whether market forces are sufficient for protecting investors' interests, also suggesting that the monitoring of investment costs falls through the lines of responsibilities within pension fund boards. Some of these problems will be exacerbated by behavioural bias and herding, as explored in section 3 and assessed in the online survey (section 4) and interviews (section 6).

Tapia and Yermo (2008) examine retirement fees in a cross-country comparison looking at Latin America, Central and Eastern Europe and find that the structure of charges adopted in different countries varies and it is complex, which means that the charges are poorly understood – and when decision-makers are confronted by uncertainty and unclear information, this is a context in which behavioural biases and herding tendencies are likely to prevail. One solution to this problem is to educate participants more effectively because experts may be less susceptible to bias and groupthink than amateurs.

In an overview of the performance and costs of domestic equity investments by US pension funds, Bauer et al. (2010) highlight existing findings, which diverge from pension fund underperformance (Brinson, Hood and Beebpwer, 1986; Ippolito and Turner, 1987; Lakonishok, Shleifer and Vishny, 1992; Elton, Gruber and Blake, 2006) versus outperformance (Brusse, Goyal and Whalal, 2009). However, it is unclear why this variation exists. Ambachtseheer, et al (1998) suggest that pension fund poor investment performance can be attributed to pension fund size, organisational design and the proportion of assets passively managed. Another study by Ibbotson and Kaplan (2000) highlights the significance of appropriate asset allocation above all else in explaining the difference in pension fund investment performance.

In their cross-country comparative study on pension fund costs where costs across Australia, Canada, the Netherlands and the United States were compared, Bikker et. al. (2012) find that higher investment service quality and more complex pension plans raise costs significantly. Administrative costs particularly vary significantly across pension fund types with differences amounting to 100%. Authors note that even small differences in administration costs can have a very large impact on the net rate of return on pension contribution. For example, a number of studies suggest that an increase of 1% point in annual charges on assets for a pension fund results in a reduction in future benefits of 27% after 40 years of contributions (Bateman, Kingston and Piggot, 2001; Brikker and De Dreu, 2007; Bikker et al, 2012). Little analysis has so far been conducted on behavioural bias and herding as factors underlying under-performance

Pitt-Watson et al. (2014) provide the latest comprehensive overview of published literature on investment costs in Britain and around the world – finding that pension fund costs are obscure and inaccurate. One of the few indications of the loss of value in retirement income comes from the report of pensions charges in Ireland. This report collected information on the level of pension charges levied on pensions arrangements in order to assess whether charges are reasonable and transparent. Worryingly, the report identified significant differences between disclosed and all-charges for different retirement arrangements where all-charges on average are 3% higher than disclosed charges for every retirement arrangement (Department of Social Protection, 2012).

Measuring pension fund investment costs

Pension fund investment costs differ significantly between actively managed and index-linked funds and their impact is often little understood by investors, who are not always aware that they are being overcharged (Christoffersen and Musto, 2002). For example, Bogle (2014) uncovers some estimates of the additional costs that investors incur when they invest in actively managed funds – costs which are not incurred by index-linked funds. These additional costs include: transaction costs, cash drag, sales loads as well as excess taxes. Bogle (2014) suggests that the portfolio transactions costs alone for active fund managers have increased substantially as the fund portfolio turnover has leaped almost fivefold from 30% in 1960s to 140% today. This reflects a misalignment of incentives and of decision-making power, exacerbated by groupthink and bias. Investors are often a diffuse and uncoordinated group. Malkel (1995), Gruber (1996) and Chan, Chen and Lakonishok (2002) find that, on average, mutual funds underperform the market by the amount of expenses charged to investors. Yet, it is near impossible for investors to figure out how much their investments are costing them because additional costs are hidden and too high (Haslem, 2004; 2006; Ellis, 2012). Indeed, the all-in fund costs have rarely, if ever, been estimated because the data on such costs is almost impossible to quantify. Furthermore, Bader and Gold (2007) have highlighted that pension funds overlook costs associated with different types of investment risks, which are also little understood by trustees.

Furthermore, Bikker (2013) provides evidence that higher costs incurred by mutual fund managers do not lead to higher returns. He asserts that since the investment operations of pension funds and mutual funds are similar, it is reasonable to expect that this result would hold for pension funds as well, concluding that beneficiaries are likely to be best served by pension funds with low investment costs. Carhart's (1997) study into persistence of mutual fund performance casts considerable doubts on fund managers' stock-picking skills. Indeed, extensive academic and industry research shows that in every single time period and date point tested, low cost funds beat high-cost funds (Kinnel, 2010; Sharpe, 2013; Bogle, 2014).

Notwithstanding progress made in calculating the all-in investment costs, Bogle (2014) demonstrates that, over the long-term, compared with costly actively managed funds, low-cost index funds create extra wealth of 65% for retirement plan investors, providing a truly remarkable improvement in the standard of living to retirees. Bogle re-emphasizes the significance of the need to understand the impact of additional costs emerging from boundedly rational, counter-productive behaviour, urging an even more rigorous analysis of investment costs not only in the short-term but also the significant negative impact these costs have on the long-term saving. These insights connect with the insights outlined above from behavioural economics and finance, about the systematic biases that emerge in financial decision-making. In this context, the fact that investors persist in using active managers may reflect systematic biases such as over-confidence.. This research takes a first step in assessing some of these issues, also taking into consideration the increasing push for transparency in financial services within academic research (Hebb, 2006; Edwards, et. al, 2007; Frynas, 2010; Aggrwal and Jorion, 2012; Pitt-Watson, 2014) as well as financial services industry (Foster, 2016).

6. QUALITATIVE RESEARCH METHODS AND ANALYSIS

In assessing some of the influences outlined in section 5, this section sets out the approach used for the qualitative research, and the key findings identified from a series of interviews. This qualitative research, in conjunction with the findings from the online survey as described in section 4, is aimed to increase our understanding of market participants' views about whether or not there were obstacles to oversight committees making effective investment decisions. It explains the qualitative research methods used; the sampling of asset owners; the process of gaining access; how the data were collected and analyzed and presents the findings from this work.

6.1 Data Sources and Data Collection

This study adopts an inductive mode of investigation and uses semi-structured interviews both with individual respondents as well as focus groups. Semi-structured interviews are suitable in situations where the researcher seeks to understand interviewee's constructs to explain his or her opinions and beliefs about a certain situation or issue and when it is necessary to understand the interviewee's 'world' (Easterby-Smith et al., 2002). Although conducting interviews consumes a lot of a researcher's time and effort, it is believed that semi-structured interviews provide the best opportunity to explore participants' values, norms and experiences (Stephens, 2007). Qualitative data allow the researcher to get close to actors and settings in order to examine relationships and understand complex practices (Shah and Corley, 2006). To understand the dynamics of decision-making of the asset owners' oversight committees, pension funds were used as a lens. The aim of this task was to collect data from experts involved in pension funds governance and investment.

Theoretical sampling was used, which is closely associated with grounded theory methodology and which can be defined as "the process of data collection for generating theory whereby the analyst jointly collects, codes and analyses his data and decides what data to collect next and where to find them in order to develop his theory as it emerges" (Glaser, 1978, p.30) to identify whom to interview. First, pensions and investment experts were approached, through an industry transparency forum, which is made up of over 100 experts in financial services, investment and pension fund governance. It is important to note that the sample of interviewees were drawn from this forum and we expect that, as a result, those interviewed are much more engaged and alive to the concerns about the limitations and constraints on effective decision-making, compared to the general population of institutional investors.

An effort was made to engage with diverse pension fund actors in order to appreciate the variety of different roles and possible influences within investment oversight and decision-making. Thus, the interview program covered the roles of trustees, pension fund executives and pension fund investment experts, including legal advisors. As the fieldwork progressed, the research benefitted from a 'snowball' effect in getting access to the interviewees.

To guide the inquiry, a semi-structured interview format was used, based around an interview protocol designed specifically for these interviews. This protocol was also sent out to potential respondents electronically. Participants were asked to discuss the questions from their own experiences. Accordingly the choice of interview questions did not only depend on the overall themes of interest but also on the respondent's role, background, expertise. Data collection took place in April 2016 in London.

Creswell (2007) suggests that twenty to thirty interviews are sufficient for building grounded theory, and this figure served as an approximate indicator of the extent of the interviewing component of the fieldwork. Subsequently, the data saturation point was reached after conducting around 15 interviews, as it became apparent that further distinct themes were no longer emerging from the interviews. All in all 17 interviews were conducted and 5 additional comprehensive written responses were received during the fieldwork. All interviews were digitally recorded and transcribed. Appendix II provides the list of respondents. Appendix III contains the interview protocol.

Data collection and analysis occurred concurrently with the interviews. The process of initial data analysis began during the data collection in April 2016 with more in-depth analysis in May 2016. The data analysis was inductive and interpretative and aimed at obtaining deeper understanding of the processes and relationships within investment oversight committees as well as the group dynamics within the decision-making process. Content analysis was used to analyse the interview transcripts. To guarantee the robustness of this data analysis, techniques similar to those used by Eisenhardt (1989), Dacin et al. (2010) and Tilba and McNulty (2013) were implemented. These consisted of four steps. NVivo 11 qualitative research software was used to assist and facilitate the analysis of the qualitative data.

In the *first step* of the analysis, interview transcripts – entered in NVivo as text files – were coded on the basis of 'in vivo' words. These comprised of descriptions offered by interviewees, revolving around overall complexity within financial services, oversight committee governance, effective oversight and decision-making. These formed the first-order codes or 'nodes'.

In the *second step* of the analysis, second-order codes were identified. For example, comments on the first order code such as 'Pension Fund Governance' were further grouped into codes or 'tree nodes' labelled 'Trustee Priorities', 'Investment Management' and 'Group Biases'. Following Lincoln and Guba's (1985) recommendations, the second-order codes were then refined through triangulation of interviews. This process resulted in 711 coded passages.

In the *third step* of the analysis, links between second-order codes and higher-level codes/nodes were collapsed to produce theoretically distinct themes – for example, the node 'Investment Chain Complexity' was further grouped into nodes labelled 'Conflicts of Interests' and 'Fiduciary Management' and 'Future Trends'. This was a recursive rather than a linear process; with analysis moving iteratively between the first and second-order codes, with patterns in the data emerging into conceptual themes (Eisenhardt, 1989; Dacin, et. al., 2010).

In the *fourth step* of the analysis, the emerging conceptual themes were organized into the overarching themes that inform our main findings and theoretical reflections. Three themes strongly emerged here: trustee lack of expertise and reliance on external expertise; complexity within investment management; and group behavioural biases.

Using NVivo allowed the interview content to be analysed systematically using codes, keywords, word frequencies, reference counts, quantifying theme coverage and theme cross-comparisons. The interviewer aimed to ensure that during the interpretation, the data was linked with the research questions and concepts, and there was a close fit between the data and the research claims (Easterby-Smith, et. al., 2008). To help improve accuracy, respondents' feedback was also sought where possible (Lincoln and Guba, 1985). Usually this was done during the interview process, by reiterating the respondent's statements, to make sure the intended message was understood correctly.

6.3 Research findings

These research findings reveal that trustee boards are dynamic groups in which trustees face a number of influences and behavioural biases when they make strategic decisions. In twenty-two responses there were 114 unprompted references made to behavioural biases and 53 references to the various influences during the decision-making process. Several distinct themes emerged from the interviews: fear of complexity, (over)reliance on external investment experts; dominant chairs and Devil's Advocates, groupthink and herding, and over-confidence. As explored in section 3, these types of biases are identified by behavioural economists as affecting a wide range of human behaviours, and gain more traction in this context because in environments of uncertainty, diffused responsibility and poor information, these biases have more influence because there is a range of possible decisions, for each of which the outcome can only be known with the benefit of hindsight. All these influences and biases seem to create obstacles to challenging the investment experts, which may lead to ineffective decision-making. The study also finds that, within pension fund governance arrangements, investment complexity, little understanding of opaque investment costs and charges, hinder rather than help with effective oversight by trustee boards. Furthermore, trustees' key priorities have been pension deficits, underfunding and the associated pressure to have investment strategies that would address this problem. These priorities seem to come at the expense of other considerations such as more scrutinised monitoring of investment costs and charges. When it comes to Fiduciary Management, the study finds that the concept is loosely defined within the financial services industry and is not well understood by the institutional investors, which can be to the detriment of consumer interests. These findings are elaborated next in more detail, starting with behavioural biases.

6.4 Trustee Decision-Making – Psychological Influences

6.4.1 Fear of complexity

Interviewees reveal that often trustees experience a fear of investment complexity and subsequent fear of asking questions and appearing ignorant in front of other board members. Using a specific example of pension fund investment costs and charges – one of the respondents, a pension fund expert who advises local government pension schemes, commented that most trustees do not request their fund managers to iterate all costs because:

> *'…there is an inherent fear of complexity. Part of that fear is driven not just because it is perceived as complex, and people don't like to reveal their ignorance. There is a fear that if they are shown to be ignorant on this cost issue, and they are shown to have been complacent… and I would say that every trustee, either through ignorance, complicity or through just not knowing it was an issue, they are all culpable in some way for not having digested this problem of costs. Because the costs are so much higher than people believe, it seriously detracts from the performance of a pension fund (Respondent 14).*

This respondent went on to say that:

> *'Because there is an unwillingness to deal with this new level of complexity – and this new level of complexity is that there are lots of different costs…so we have a problem. We have a set of stakeholders over here who don't want to give the data for whatever reason – it may be cynical or otherwise – and we have a group over here who are frightened of asking because, actually, it is complicated, or they may look stupid, or it requires them to challenge in a way they haven't challenged before…those whose job it is to look at costs are frightened of that because there is a chance that they are going to look stupid, because they could have done it ten years ago and never did. And, as a result of it, the pension funds are 20% underfunded' (Respondent 14).*

One pension scheme officer echoed the above statements when he was elaborating on the dynamics of trustees' decision making within his pension fund when he suggested that trustees are often 'stressed' when they are faced with making an investment decision because they lack the required knowledge to make those decisions:

> *'One of the most interesting physiological issues, when people are faced with knowledge requirement and it produces stress or they are in a stressful situation because they are the Trustees of a pension fund, it often leads to poor decision making because of the stress response that you get so, the most common one that I've seen is silence…So if you're*

talking to Trustees as I've done, particularly around costs, they go quiet. They go quiet because it's causing them stress in the brain because they don't understand what is being talked about or they fear that they have been in breach of what they should be doing' (Respondent 2).

The interviewee went on to suggest that fear of complexity and a lack of ability to ask questions and challenge often results on trustees '*buying something without knowing what they are buying*'. In turn, this allows the investment consultant to sell '*the most sophisticated*' solutions *'without realising the most sophisticated and clever thing they [the investment consultants] could possibly do is to come up with a strategy which the other people can actually understand'.* Another respondent, an independent Chair of Trustees from a medium-sized pension fund had admitted that he found dealing with pension fund investment issues difficult because of the level of complexity involved. Using the example of doing Trustee Toolkit investment modules the interviewee admitted that:

'…it's terrifying when you answer the question, and you press the button to see if you've failed or not, and I think my fellow trustees are, probably, a bit intimidated by the investment module, because it's a bit scary' (Respondent 4).

Although there were a number of positive comments made about the usefulness of Trustee Toolkit in helping trustees improve their investment knowledge, questions still remained about the quality of the debate within the trustee committees. The following statement from an independent Chair of Trustees captures this dynamic:

'…do they [trustees] challenge? No, not really, because I think this is another aspect of chairing, and it happens at board level. When you get to the top level of an organisation, you've got there by reputation and status. Chief executives are not very good, typically, at saying, 'I haven't got a clue', because their expectation of themselves is, by the time they get to the top, they are essentially perfect. If you're an HR director, you're used to saying, 'let me go through that one more time', and you haven't got the ego that is at risk by admitting … and everybody else says, 'thank God he asked the question', and that's what I do as a chair, I will try and

anticipate what those guys are really, desperately, trying to work out, and ask the question as if I didn't understand it' (Respondent 4).

The discussions about trustee board dynamics and the apparent fear of investment complexity and a fear of asking questions so as not to 'lose face' was closely associated by respondents with trustee (over)reliance on external investment experts (primarily investment consultants).

6.4.2 Reliance on external investment experts

Trustees have the power to decide the investment strategy, invest scheme's assets and appoint investment fund managers. Considering that most trustees are not investment experts, most pension funds follow the requirement of *The Pensions Act 2004* and draw on the advice of the external investment consultants while making strategic investment decisions. Interviewees highlighted that investment consultants have a crucial role in shaping pension fund investment strategy – firstly, in determining the asset allocation; and secondly, in recommending the fund managers who would carry out that strategy and run the investments. They produce a long and short list of fund managers for trustees to consider. Then the potential fund managers present pitches to the trustees – in what are commonly known within pension fund investment practice as 'beauty parades'. At these beauty parades, pension fund trustees and executives are exposed to the sales pitches from a number of different investment managers. The potential investment managers are offering investment products and trying to persuade the trustees that they are the ones who could produce the best investment returns and outperform other fund managers in their category. So the beauty parades are an opportunity for trustees to 'shop around' for the best offer, ask questions and probe for weaknesses. Before the beauty parades, trustees typically undergo training sessions to learn more about a particular investment product to be introduced during the presentation. For example, if a fund manager specializes in derivatives then the trustees would first be given a 'crash course' so that they can learn what the product is and what it does.

The data analysis reveals that respondents' opinions of the quality of investment consultant's advice varied from '*very good'* to a large majority rated as '*mediocre'*. A head of financial research in one of the investment research firms in London had commented that it is common for the investment consultant to steer pension fund investment committees and offer either '*pseudo-scientific quantitative strategies'* or '*everybody else is doing it'* or '*the regulators are expecting it*' and/or '*make sure you can't get sued for this*' strategies. There is some evidence to suggest that trustees are more likely to agree with their investment consultant without questioning because they have established long-standing relationship with their advisor; because they trust the 'brand name' and because they lack expertise. This may lead to trustees over relying on and/or not effectively challenging external advisors. The following statements from a number of respondents highlight this dependency:

> *'I think there is some comfort in the length of a relationship [with an investment consultant]. And it's a trust thing. It is part of the brand, part of a consultant's brand, I think, which the asset managers don't have' (Respondent 6).*

> *'I think many of the advisor relationships have been allowed to evolve over the years and quite often the advisors just get away with dictating the agenda rather than the other way around… you work with an individual and you trust their advice because you don't know…you know a fraction of what they know' (Respondent 17).*

> *'If I'm going to be cynical about the industry, the direction that the trustees go can be very much determined by their trusted advisers and what the trusted advisers are most comfortable in advising on. I think a lot of experts, be they the supplier or even the consultant, they may be appointing, they have too much control sometimes. If a trustee board, as soon as they make the decision to bring somebody external in because they've acknowledged that they need help, sometimes use them as a crutch and lean on them a bit too much. I've presented at trustee board meetings where the trusted adviser is on the board, they're sitting there and usually it's always an investment consultant, that's usually the hardest area for a trustee to know the detail (Respondent 11).*

> *'I've actually had trustees turn around to the investment consultant to ask them about an administration point because suddenly he's the trusted adviser, or she. They're asked everything… I think a lot of decision-making goes quite badly wrong if people forget who the actual roles actually are.*

You get people thinking that because they have an opinion, they can actually make a decision and that's not always the case. I think some boards lose their way if they don't know, ultimately, who is actually allowed to make the decisions' (Respondent 10).

'And so in any professional consultancy situation there's the old adage that, "Well, why would you go against the advice of the professional advisor you've paid to give you advice in the first place?" But add on to that, the fact that, "Well, he or she has been here longer than I have anyway," so that creates another potential layer of... what's the word I'm looking for? It's another factor that might lead a member to not question something that otherwise might need to be questioned (Respondent 7).

When respondents discussed trustee board decision-making processes, they have indicated that it is the consultant who '*tells them'* how to allocate assets and which fund managers to appoint. The pool of investment consultants is dominated by a small number of very big consultancy houses. One of the interviewees, a long-standing investment expert and a trustee, has described trustees as '*naïve and not knowing what they don't know'*. Surprisingly, it also emerges from these interviews that investment consultant's advice is very rarely challenged and/or their performance monitored because: '*consultants make this almost completely impossible and have threatened to sue firms that tried to offer these services'*.

6.4.3 Group influences

Discussions with pension fund trustees, executives and senior investment officers paint a picture of pension funds herding into investment strategies i.e. following each other in buying investment products that may not necessarily reflect the specific needs of individual funds and their long-term investment time horizons. The data analysis suggests that this herding behaviour can be attributed, in part, to groupthink within trustee boards. A focus group discussion with five pensions and investment experts reveals that herding and groupthink are one of the key challenges for trustees. The following extract from this focus group illustrates the problem:

'If someone used an investment consultant, someone else will also use it, so it becomes a compelling situation, where we all organise the same

way; we are all thinking within the same framework, and there is a good reason for that. You don't want to be caught off-guard by underperforming, whilst all of your friends are performing. Like benchmarks, forget whether or not the benchmark is adequate, whether the benchmark fits the objective given to the trust; what's important is not to be too far away' (Respondent 15).

Conversations with trustees and other pensions experts reveal that pension fund investment performance is evaluated based on risk aversion through peer benchmarking. According to one pension fund trustee:

> *'If [fund manager's] investment performance is above the benchmark, then you are better off, if you're worse, then something must be done…if you look and listen to strategy presentations for the last three months, they all say the same thing. Why? Because they are scared to be wrong…it's a "covering your arse" strategy…and the drive to cover your arse is stronger than the drive to look after the interests of the clients' (Respondent 8).*

Another interviewee, a Chair of Trustees, also highlights that it is important to avoid the risk of investing in the wrong investment products and going into the Pension Protection Fund by comparing investment performance with other schemes as the following passage illustrates:

> *'If a lot of pension schemes are doing it, and you're in the middle of that, the government is not likely to want to see lots of pension schemes falling by the wayside. So, you know, I think it's important to be in the, sort of, main stream of the field as a whole' (Respondent 1).*

It emerges that pension fund trustees use benchmarks because there is a sense of security in the knowledge of being in the group and not standing out with doing something different on your own, especially if other strategies do not perform as the benchmark norm. Furthermore, given earlier evidence of trustee reliance on external investment experts, it was unsurprising to find that consultants and their recommendations were considered part of the herding problem because, as one actuary suggests, *'there is a very small talent pool [of consultants] and that talent pool is typically saying very much the same thing. There is not a lot of diversity between them and that leads to herding behaviour'*.

In a written response to the interview protocol, a law professional offered the following view on the current investment market:

> *'The concept of 'market practice' is an example of groupthink – possibly one of the worst cases of groupthink in history – most trustees (and, sadly, most of their advisers) consider that the optimum outcome is to get the same terms as everyone else, however bad those terms are. The industry has an effective cultural immune system which dismisses anyone who challenges market practice as an amateur – and the sheer number of people involved in the chain makes change almost impossible – if you convince the trustees, the investment consultant protests; if you convince the investment consultant, the scheme secretary protests; meanwhile the manager is pulling out all the stops to convince everyone involved that since every other pension scheme has signed up to these terms, your advisers clearly don't know what they're talking about etc. I've even had managers contact my colleagues to try to get them to exert pressure to water down the legal advice – in some firms, this works.*
>
> *A further example of groupthink is the idea that trustees must get the 'best in class' manager at any cost, so the terms on which the manager is appointed are viewed as largely irrelevant. Some participants suspect that this is untrue, but since everyone else believes it, often doubt themselves: in one trustee meeting I was in recently, the independent trustee wanted to select the manager with the better terms but backed down, saying 'I suppose picking the manager by terms is the wrong way round'. In fact, there is little or no evidence suggesting that manager-picking adds any value at all to a portfolio … outperforming managers may simply have been lucky. Governance is viewed as a soft extra, as having low value compared to 'getting the best in class' – a view possibly encouraged by the consultants who have built an industry around 'picking managers' (Respondent 13).*

The herding behaviour seems to be a result of a lack of thought leadership with little challenge of the '*orthodoxy*' or the '*common wisdom'* of the investment advice provided by consultants, exacerbated by what appears to be a common assumption among trustees that their investment management agreements (IMAs) are *'written in stone',* where in some cases fund manager's reputation and arrogance during the ‘beauty parade’ was considered as reassuring. In short, it is *‘simply the way everyone does things – a market practice…it is very difficult to be the five or six pension funds who are arguing with the managers when you’ve got another 1600 who aren’t’.*

There is some limited evidence to suggest that trustee committees are using a Devil’s Advocate to help address groupthink and herding. At the same time, discussions with trustees and other pensions experts also suggest that in many cases trustees are over-reliant on the board Chair in their decision making process.

6.4.4 The Role of a Chair and Devil’s Advocate

Another theme which was frequently articulated by interviewees when they were discussing trustee board dynamics related to the role of the Chair of the Board. Discussions with trustees, pensions experts as well as some of the Chairs revealed that the quality of chairmanship across pension funds vary from ‘*excellent to very poor, dysfunctional, ineffective’* chairs. One pension fund officer characterised a ‘dominant chair’ as someone who:

> ‘…*doesn’t necessarily bring everyone in, or who can be intimidating, or who forms views and tells the board the views they should follow*. *Who is a very nice person but didn’t have the intellectual capability to follow the discussion of some of the issues that were going on and also on the back of that couldn’t necessarily summarise at the end some of the actions that were to be taken, or couldn’t bring the discussion to a close and meetings would go on and on and on and on’ (Respondent 17).*

Interviews reveal that, quite often, trustee chairs would come from professional pensions background as opposed to people with chairing skills, influencing the board discussions by ‘always chipping in’ so that ‘*everybody is abundantly clear about what the Chair’s view is’*. On the other hand, a good and effective chair would be someone who has the skills and individual ability to conduct and moderate a meeting. One Chair of Trustees has commented on the significance of his role by highlighting that:

> *‘The ability to chair meetings is crucial, because you sit between the employer, the elected and nominated trustees, and the actuary and, with the best will in the world, actuaries, these days, are no more educated than they ever were;*

they are dispensers of expertise, you go to the oracle and ask for the answer, and the actuary gives you the answer. When you say, we don't quite understand that, he gives you the answer again with a forty-page presentation. If you're in front of nominated and elected trustees, off the shop-floor, they haven't got a clue, so the most crucial role, the most crucial insight I can offer you, is there needs to be somebody, I believe, these days, in the board of trustees who is cognisant, and aware, with the words, with the jargon of pensions and fund management. The real expertise is in knowing when to say stop, when to say you don't understand, when to say no, that's not good enough, we need a different explanation of that, and those, I honestly believe, are critical skills' (Respondent 4)

The interviewee went on to explain:

'I am the independent chair, and my job is to be the independent chair. I'm interested in getting the most of the anthropology of how you chair meetings, in a complex area. Let's face it, you've got complex investment, you've got complex economics, you've got complex pension rules and regulations, every day new stuff and, overlaying that, you're supposed to look out twenty years into the future; can you give me anything that's more complicated than that? Boy, you need interpretation, and I see my job as, if you like, the interpreter between the employer, the trustees and the advisers' (Respondent 4).

It emerges from conversations that the key role of a Chair is to bring board members into the conversation, where everybody is confident enough to contribute to the discussion. It is also about the ability to interpret what is going on around the table:

'So, being a chair means reading what's going on, and you're looking at that person over there, and you can see the furrowed brow, and you've got to make a guess and say, 'they're struggling, and they don't quite know how to ask the question', and then you're watching all the time to see … it's the dynamics, that's what chairing is; it's not about saying, 'item four, item six', it's about watching the dynamics' (Respondent 4).

Five respondents out of twenty-two in this study, including non-executive Chair and a Chair of trustees, have indicated that they have been playing Devils' Advocate to provoke discussions within trustee boards. This was done on an informal ad-hoc basis, with no formal process, with trustees coming to a 'common view' by the end of the discussion. There was one instance where the Devils' Advocate or 'Critical Friend' role was taken very seriously and fulfilled by one of the members of the pension fund's governance committee – a committee which had only recently been formed within one Local Authority pension fund – to '*ensure sufficient oversight of the fund's compliance with the various different rules and regulations it has to follow… [and] to critically assess the decision-making processes and to offer our own independent views on the day-to-day workings and decisions of the fund'.*

However, it is not clear whether this interpretation of a chairman is widespread across pension funds and whether trustees are taking an active part in board discussions. This study finds some preliminary evidence to suggest that there may be a dominance of a trustee chair across pension funds where trustee boards have limited investment expertise, particularly if a chair is a senior person with the sponsoring employer. There is evidence to suggest that such dominance leads to trustee disengagement from the decision-making process and confusion about the lines of accountability and responsibility, particularly when it comes to discussions with the investment consultant and investment decision-making. One pension fund trustee board member has described this group behaviour in the following interview extract:

> *'The classic problem is around the use of things like hedge funds…what happens is – and this is a real behavioural problem – in a meeting with an investment consultant they [trustees] will nod their head saying, "We know what we're doing," and then they say, "Okay, we'll go away and we'll sign the papers and we'll send them back." Then as soon as the investment consultant walks out of the meeting, "I didn't understand a word of that"…So instead of being decisive with the investment consultant, they quite often will – I've seen this happen at a lot of trustee meetings – they will sit there they will just look up at the ceiling and pretend that they're hearing it but it's just going in one ear and out the other because they haven't got engagement with the issue. And they certainly can't educate themselves because they haven't got the tools. So they're not empowered to take the decision' (Respondent 2).*

It emerges from the interview data that in a case where there are different parties involved with different investment matters – i.e. actuaries, investment consultants, investment sub-committees, investment directors, etc. it seems to be difficult for all involved to pinpoint who is actually responsible for what because '*the chairman of the investment committee would look at the investment advisor; and the investment advisor would look at the internal investment director; who then would look back at the chair of the investment committee'*. There seems to be some lack of clarity around who is responsible for setting the investment strategy, the implementation of that strategy, the monitoring of the fund managers and investment consultants. There is some evidence to suggest that the chair would be the one who would spend more time on assessing different options and developing recommendations to the board, and trustees would '*normally listen to with particular care to what he has to say'*. For example, in one local authority pension fund the chair was '*a City man'* who did 70% to 80% of talking during the investment committee meeting.

6.5 Other influences and challenges to trustee decision-making

The interviews reveal a multiplicity of different qualitative influences at play during trustee board meetings. Some examples of that would be a trustee board choosing a fund manager based on his accent, looks, best and clearest presentation graphs or who has the least amount of words in their presentation.

There also seems to be a feeling of unhappiness and pressure associated with pension fund deficits and underfunding where *'trustees feel that they've done what they were told to do, taken advice on investment matters, and still the scheme is in deficit, still their employer is being asked to find extra money, which effectively is an admission of failure on behalf of the trustees, so there is a constant feeling of failure inside of trust boards, which is very distressing from a morale point of view…there is a pressure to wind down schemes with employers who are not prepared to pay any more than they have to so there is a feeling that the actual scheme doesn't matter'.* These underlying emotions reveal tension of different interests, particularly within occupational trustee boards. When trustees make decisions they need to consider the employer, union and member nominated trustees interests, which are not necessarily aligned. One pension fund governance expert has highlighted this misalignment by saying that:

'the trustee and the sponsoring employer are coming from completely different angles on funding, investment strategy, resources, costs – and being able to sit on the board and make decisions which might not be in the employer's best interest is quite challenging but also to be aware that some decisions might put the employer out of business…let's say where there are two different contingencies on the board, a member nominated contingency and an employer one. The employer trustees might discuss aspects that will come to the board amongst themselves and member nominee trustees might discuss the issues amongst themselves, instead of all discussing it together and then that leads to lack of trust between the two groups of trustees' (Respondent 17).

Another respondent who is an actuary had illustrated these conflicts of interests using the example of a decision of appointing an investment consultant:

'One of the problems that a lot of trustees have is they're constrained about the decisions they take with regards to investment consultants because of global agreements…[name of the company] have a global agreement with [name of the investment consultant] that they will use them for everything or as much as they possibly can do. So [name of the investment consultant] are their investment consultants. If for some reason the trustees fall out with their investment consultants and don't feel they're getting value for money, there is nothing they can do about it, or very little they can do about it, because it depends on their sponsor who is saying, "We want [name of the investment consultant] as the consultants." So you do get this conflict. So it's not always in the hands of the trustee which consultants they use because quite often they're under a lot of pressure from the sponsor, who is paying the bills, to use certain consultants. So that's the conflict. I'd say that often happens' (Respondent 5).

Within local government pension schemes the different interests are represented by different politicians/councillors who get elected into the Council. Their presence on the pensions committee is in part determined by '*the colour of the rosette they wore at the last election'.* There is evidence to suggest that some pension schemes employ an independent professional trustee to deal with any such conflicts of interest. However, interestingly, there is a near 50/50 split in opinion about the actual usefulness and benefit of employing professional trustees, with about half of the interview respondents considering professional trustees to have a vital role in ensuring a more effective investment oversight and decision-making, while other half of respondents were questioning the value and ‘independence’ of professionals working for a fee.

6.5.1 Trustee meetings, decision making process and group dynamics

The above research findings reveal that trustee boards are dynamic groups where trustees face a number of behavioural biases when they make strategic decisions. These findings highlight that ‘*it doesn't matter how many facts and figures trustees might pretend to analyse, people make decisions emotionally’*. There is evidence to suggest that trustees make strategic decisions as much on emotions as objective evidence. The following vignettes provide distinct examples of different group dynamics and influences during board meetings.

A former trustee and an investment advisor captures the decision making process based on the worst rather than best presentation:

> *‘I was involved, quite a number of years ago…I'd gone through to get to a selection committee. There was three organisations presenting in a final beauty parade. One organisation, the owner came along of the organisation and was a dreadful presenter but managed to impart to the trustees, among all of these very, very slick presentations that were on either side, that somehow managed to impart that he hated losing money. I remember one of the comments at the end of the meeting and they said, I think it was the finance director who was part of the decision making, he said, "If I wanted somebody to invest my money, it would be that man, my own personal money.’ Everyone agreed because it was a dreadful presentation. I mean he wasn't a presenter. He built up this business himself and it was very well established, a billion in hedge funds, which is quite an adequate size. They won the pitch. They won purely because of the contrast…I remember, I was one of the consultants and I was just laughing. To win a presentation having the worst presentation. To win a pitch because your presentation was the worst, and they acknowledged it was the worst presentation. You end up with a shortlist but you still end up with the human behaviours’ (Respondent 21).*

Another pension fund expert gave an example of behavioural biases within trustee board during fund manager selection at a ‘beauty parade’ within local authority context where trustees made their selection not based on empirical evidence but because of their future investment plans in a local supermarket:

> *'…at this particular meeting that I was invited along, I was witness to an interesting behaviour. They [trustees] were picking a new property fund manager. And the room was very full, and no-one seemed surprised. These are deeply dull meetings, but the room was full of activists and other people who were scheme members of the pension fund. And yes, it was actually packed. And the reason why was there were three property fund managers in the room, each presenting their final presentation on why they should manage this new mandate for whatever it was – £30 million worth of assets under management in the property fund. And the room was quiet for the first two, and when the third one… that actually, empirically, when I was looking at it, thinking, "Well, actually, that's a pretty weak presentation." They mentioned during that presentation that one of the assets that they were going to invest in was a supermarket in one of the wards, in one of the council areas, within this pension fund's remit. At that point, the room erupted with enthusiasm and cheers… the board of the pension fund is sitting there watching this, and looking at the people who could otherwise disrupt the meeting agreeing strongly with one option. Not the other two, who were bigger, more professional organisations, but the third one. And it turns out…afterwards, I spoke to one of the property fund managers, and he explained what had been going on. He said, "We made a mistake. What we should have done is we should have promised, and been speaking to the ward councillors and other members of the pension fund, about the fact that we were going to build something locally for them. And we would have encouraged them. We would have told them the date of the meeting and encouraged them to come along. That's what the third manager had done. And all of the people with a vested interest in seeing that new supermarket, that new shopping centre in their area, had turned up to lend support to that asset manager. Regardless of their empirical performance, what the board got was a very clear signal of that in the room. And therefore, as a consequence, that was the fund manager that was picked. I saw them making a subjective decision without following the objective selection criteria, purely because it made their lives easier' (Respondent 14).*

Generally, trustees meet four or five times a year (once a quarter as a working rule) with more meetings taking place as and when needed. For example, when investment fund managers are selected, trustees typically meet to assess the 'long list', then meet to assess the 'short list', followed by a meeting to make the final selection. It is not uncommon for trustees to rely on observations made by their investment consultant in their report on fund managers and these become '*a feature of the questions that are then asked of the fund manager. And equally, it is fairly common that the discussion that follows those questions involves the investment consultant.'* During regular meetings, trustees would monitor most investment-related aspects through reports, which cover '*ongoing monitoring activity'* where '*individuals would flag up specific issues which ought to be raised with the chairman'*.

Trustee board meetings are usually attended by advisors – an investment consultant, a scheme actuary, a lawyer, the administrator and/or a secretary. There may be a pension's manager from the employer. The evidence from this study suggests that it is quite typical for trustees to agree with their advisors and follow their recommendations. Decision-making may become complicated when advisors in the room provide conflicting advice, in which case trustees seem to struggle to mediate the dispute despite the training in various governance and investment topics they often undergo. When it comes to due diligence process, one trustee has indicated that 'in practice it relies on a much smaller number of people' because not all eight or twelve members would ask questions. It emerges from the interview data that the quality of discussions varies greatly across trustee boards – and not necessarily due to the size of the scheme, or to the expertise of the trustees. As a general point (which does not apply to all trustee boards) there can be an over-reliance on advisers, which seems to be exacerbated by *The Pensions Act*, which includes provisions requiring trustees to obtain advice..

6.5.2 Pensions Deficits

One of the most spoken priorities on trustees' agenda was pension deficits, underfunding and the associated pressure to have investment strategies that would address this problem while managing both the assets and the liabilities in the process. For example, one pension fund and investment expert has highlighted that:

> *The average shortfall in funding of a local government pension scheme is in the order of 20%. It's an absolutely phenomenal amount of money, and that*

risk is underwritten by the British government and by the consumer. This is the same paradigm that every corporate DB fund has' (Respondent 14).

Another respondent (an actuary) echoes this view by saying that their main constituency are the pension funds that:

> *'…don't have enough money in the pot. And the reason they don't have enough money is because, first of all, the assets haven't worked as hard as they were expected to work, and secondly, because their liabilities are a lot bigger than they were expected to be at previous points. And basically what the trustee is relying on in order to do their work is for a series of assumptions made by actuaries to come true. And consistently those assumptions aren't coming true' (Respondent 5).*

But it is not just about investment decisions and investment performance – another important trend in pension fund trustee board discussions is the move from the defined benefit (DB) to a defined contribution (DC) arrangement. Trustees also need to ensure that the scheme has appropriate administration and governance arrangements in place and that it is meeting all the regulations and payment timescales, that there are appropriate lines of communication with staff and scheme members.

For DB schemes, trustees also '*worry*' about the levels of employer contributions into the scheme and whether the corporate sponsor is able to maintain its contributions into the scheme. It emerges from the interview analysis that, in dealing with governance and investment decisions, many trustees don't concern themselves with establishing greater clarity around pension fund investment costs and charges. Discussions with investment fund managers and other investment experts suggest that there is a plethora of hidden investment costs and charges that trustees are neither unaware of, nor do they '*ask about the costs at any of the trustee board meetings'*.

6.5.3 Understanding investment complexity

Whilst trustees are responsible for a substantial amount of assets to invest, their decisions are affected and shaped by the complexity within financial markets. This section makes an important observation – namely, investment complexity as well as conflicts of interest within the investment chain represent significant barriers to effective oversight and decision-making by trustees, which are also not in the best interests of consumers (such as pension fund trustees and the ultimate pension fund beneficiaries). A consultant's focus on producing short-term investment returns in order to generate more business for the investment consultant and fund managers is highlighted by a former board director of one of the largest UK investment consultancy houses when he stated that:

> *'[Investment consultants have] got their financial targets, they've got their business plans, they're driven by short term financial results, and individuals managing the business are driven by financial results and cross-selling services is part of the performance management of individual consultants… you see a lot of advisors being conflicted and promoting their own product or their own solutions irrespective of whether that's right for the client for that particular trustee board or not' (Respondent 17).*

> *'I am aware that some of the consultants, they are targeted to sell their own fund management products. So you have an independent consultant, who is supposedly independent, who somewhere behind the scenes is targeted to promote their own products' (Respondent 11).*

All interviewees have indicated that investment consultants' incentives are not always aligned with the end investor. An investment consultant's business model is aimed at *'making money'* by advising, which assumes that there is an incentive for a consultant to change things within a pension fund investment strategy, advise on new asset allocation, offer new products and recommend different fund managers in order to generate more revenue for the investment consultant. One interviewee, an independent director in an occupational pension fund, has explained that:

> *'…consultants sell their wares of asset managers, because they have a benchmark, and they can sell you how to choose the best benchmark; they can sell you [on] who are the best people running those benchmarks, all this kind of nonsense' (Respondent 15).*

To echo this view from the pension fund advisory perspective, one respondent admitted that:

'as a salesman, you are never selling something on the pure grounds that it's good for you; you're always giving them [the client] a story of some kind or other, that's going to keep the interest' (Respondent 16).

Furthermore, one financial expert has highlighted the existing information asymmetries and misaligned interests between trustees and their investment advisors:

'You're not frightened as a professional member of the sell side, about increase in the levels of education of trustees, because no matter how high they are lifted, they never have adequate information or disclosure, to seriously challenge. That's a fact which you can't escape; there will always be a difference to what you need as a trustee… you're always going to be a train late' (Respondent 8).

The recommendations about fund manager selection as well as asset allocation makes the consultants extremely powerful and influential not only within the pension fund community but also within the community of the investment fund managers. Interviewees' comments about the nature of the relationships between consultants and the fund managers reveals tensions and interdependencies between these two types of actors. This study finds significant mutual dependence within investment consultant-fund manager relationships. Investment consultants rely on the fund managers for information in order to make recommendations to the pension fund clients, and the investment fund managers depend on the investment consultants for their recommendations to pension funds. In a revenue-generating environment this relationship dynamic was described as:

'…It's almost like there's a dance between the sell side and buy side; the buy side wants to be seen to be challenging, and wants to be seen to be probing, and carrying out the fiduciary responsibilities, but I get the impression, sometimes, it's actually quite superficial. They want to be seen to be behaving as they're supposed to behave. They don't behave as if it's their money. If they were behaving as if it was their money they were managing, would they be more prudent? Would they be more challenging? (Respondent 8).

Another interviewee has added that investment consultants are incentivised to sell overcomplicated investment solutions because the pension fund market is changing and many pension schemes are winding down:

'If you have a finite period of time where these trusts are going to be available for use, then why not make the most of that time? So let's sell ever more complex strategies, ever more expensive strategies, ever more self-serving strategies. And that is, potentially, the problem. And if you start getting into that spiral of distrust, where the trustees feel that they're constantly being ripped off, and the consultants just feel, well, the trustees are hopeless, inadequate, whatever, then you get into that kind of situation which we see a lot, which is a really, really bad, poor relationship between both' (Respondent 5).

This kind of dynamics suggests that investment consultants:

'*don't really work for the trustees but the asset managers, which is why you only get certain asset managers presented to certain clients by certain pension fund consultants, because they have stronger relationships with some fund managers than with clients'' (Respondent 14).*

'There's this overwhelming status quo bias…a lot of people in the chain aren't there to protect the interests of the trustees. They're there to maximise their own revenue. They want to work with their friends. They don't want their friends getting fired and getting another manager coming in who they might not like' (Respondent 13).

Consultants can and do influence pension fund investment strategy by establishing what most pension funds *'should'* be doing by way of their asset allocation and equally what the investment fund managers *'should'* be selling to their pension fund clients. Several interviewees also noted that there is a tension between consultant's need to provide a service to a pension fund client and the need to sell more services and more products, which leads to a lack of accountability in this fiduciary role. This tension seems to have created a situation of blurred roles and responsibilities where investment consultant is starting to recommend and sell its own investment management services to the client while investment fund managers are becoming 'pseudo-consultants' and getting involved in providing strategic advice such as asset allocation. Furthermore, fund manager incentives also seem to be misaligned in favour of charging higher investment management fees at the expense of consumers, as one pension fund expert explains:

'…only 20% of what the fund manager earns comes from performance fees. 80% comes from management fees. That does not tell me that your interests

are aligned in generating performance. Your interests are aligned in just managing money. That's all it is. You want the money in your coffers because, once it is there, you just earn money from it. And whether the market goes up or down; whether you are good at your job or bad at your job; you still get 80% of what you get in a really good environment. That does tell me that you are not incentivised for performance' (Respondent 14).

'…So an asset manager has got to do all kinds of jobs, or has manufactured all kinds of jobs and roles around managing assets that are additive to the actual process of decision-making about where the assets go. So when one manager's assets are on behalf of another, it's a very complex set of processes that involves interactions with brokers and custodians, market infrastructure, data providers, and so on. That piece took me nigh on a decade to understand. The chances of somebody, who has never thought about this manufacturing space, understanding what is going on, are very limited. And bear in mind you have then got to add, on top of that, the complexity of being an asset manager, and managing which assets you pick within that portfolio. But then you, as a trustee, have to decide which asset managers to pick, so you've got an additional layer of complexity' (Respondent 14).

The apparent tension between the interests of financial service providers and the end-consumers seems to be further exacerbated by a lack understanding of the investment issues on the part of legal advisors during investment manager contract reviews. There seems to be a problem within the legal industry as well because as one barrister suggests: *'this is an industry where most of the pension lawyers are actually reviewing all these documents themselves without any expertise in investment'.* This barrister went on to say that, according to one study carried out his/her law firm, an estimated 70% of investments into pooled funds are made without the trustees obtaining a legal review of the documents (which are usually voluminous). The 70% figure comes from an investment consultant, who asked to remain anonymous, who surveyed his own team. Where legal reviews are carried out, they often come with instructions from an intermediary to carry out a 'light touch' review. A full report on the terms and conditions will often result in further work being pulled by the relevant intermediary.

In addition, because of the way in which law firms are structured (every lawyer is effectively running their own business) many pensions lawyers who lack investment expertise are reluctant to pass the work to the correct person in their law firm and thus lose the fees for themselves – therefore many legal reviews are being carried out by lawyers who do not actually understand the issues. Nearly half of all interviewees have highlighted how easy it is to hide behind complexity and one of the crucial aspects of investment which is hidden away relate to investment costs and charges.

6.5.4 Understanding investment costs and charges

Very few pension fund trustees are aware that there may be excessive fund manager fees and hidden costs not separately itemised, attached to their investment management which, over time, may significantly reduce the value of pension pots. The lack of transparency around costs, as well as the unwillingness of some service providers to disclose costs, have been closely linked to this problem. Furthermore, interviewees have raised questions of whether pension funds get good value for money when it comes to investment management. One interviewee, who is a financial expert and who has been looking closely at pension fund costs has summarised this situation in a following comment:

> *'I have identified sixteen separate intermediaries; sixteen separate layers of costs between the consumer and their funds and back again, which added up to this 3.5% to 4.5% of costs. And so I started looking at this additional complexity, which I characterise as – in the DB space – an organisation which acts as an intermediary between a consumer; a further layer of complexity between a consumer and their money… And I've been doing that now for about somewhere in the region of seven or eight years. And I've reached the conclusion that the costs in this tax incentivised, long-term, for-the-good-of-the-consumer environment are probably as high as the retail fund world, depending upon the fund that you look at… And, what's more, the costs had been misreported in the previous year's annual report, and the pension fund consultant was not aware of this; and could not identify the costs … and could not agree with the cost elements that I had identified, but after the fact had to, because they were on-invoice. So it was as simple as adding up invoices and saying, "I'm sorry, but you have reported x, and actually the real costs were x plus about 50%. So could you please explain this?" And the pension fund consultant could not. So the people who are responsible on behalf of trustees – who frankly should know how to do this stuff – were not aware of what was*

> *going on. And that was just on invoice, and that doesn't include any of the things that are off-invoice, which are a lot of the implicit costs that are very complex to understand…I have spoken to a lot of trustees, or trustee equivalents. There is not a single one that I have spoken to who is in any way able to grasp, or would like to understand what these costs are… and whenever the subject of costs comes up, there is a fear of the complexity of it. There is a fear that if they are shown to be ignorant on this cost issue, then they are shown to have been complacent' (Respondent 14).*

Another pensions adviser to a local authority pension fund has similarly commented that:

> *'Trustees pay scant attention to the issue of cost…because they're not educated to understand it… there's a fear factor or an ideological capture that costs really don't matter, performance does. As long as you're getting the performance, it doesn't matter what you're paying and of course, that isn't how a pension fund should be run. A pension fund should be run with absolute ruthless efficiency. Trustees should be examining costs all over the place because leakages of cost are leakages for the members' (Respondent 2).*

Other discussions with financial experts echo these observations, also adding that over the period of twenty-five or thirty years the loss of value through hidden fees – that are not made explicit in the charging structure - if returned, could double the size of a pension pot. Furthermore, those trustees and pension fund advisors who have started to require more detailed fund managers' reporting on fees and costs have found their service providers to be un-cooperative and reluctant to provide more detailed data. There is some evidence to suggest that the fund managers are extracting significant financial benefits from the lack of trustee investment knowledge. One fund manager comment provides these rare insights into this rent-seeking behaviour:

> *'…they [the clients] don't have any idea about the costs; I never ever heard anybody, in any of these meetings, ask about the costs… because they don't see it as part of their job. I'm never going to tell anybody about costs. I'm taking twenty-percent of the value-added; you don't think I want you to know that, do you? They have no idea what the prices are anyway and, even if they did…if anyone ever does ask what the costs are, you present it to them in a way which*

is completely uninformative and, short of being an expert in fund management pricing, they've got no chance of dropping it' (Respondent 16).

6.5.5 Fiduciary Management

Out of 22 (verbal and written) responses to the interview protocol, ten have mentioned fiduciary management, broadly as a way to delegate the responsibility of investment management to an external investment specialist. It emerges from the discussions that the term 'fiduciary management' has different meanings to financial service providers and users. Terms like 'fiduciary management', 'implemented consulting', 'delegated chief investment officer' have been used throughout discussions. The financial service which is based on a concept of delegated investment management has been increasing in popularity with market leaders establishing their own versions of the service. Several respondents have indicated that 'fiduciary management' has become more of a trend or a *'market fad':*

> *'I was involved in a business, until very recently, and one of its main areas was providing advice in a fiduciary management section. We tried to create a service, not a product, a service that streamlined some of the advice for smaller pension schemes. We thought long and hard about the name because we agree that...it was some type of delegated investment management is what we wanted to write the name around. However, the market pressurised us because if we start talking about delegated investment services and the market was all moving down the fiduciary management area, because you've now got [investment consultants] openly using the term 'fiduciary management' as part of their services. You have [name of the financial service provider] who never did fiduciary management now calling their services fiduciary management...so you want to be involved in those tenders for business as a fiduciary manager so you're being compared with similar types of organisations. If you decide to be honest and try to explain the name and create a name that actually defines what you do, you will fall outside of that circle of organisations. So it's a marketing spin' (Respondent 10).*

However, apart from 'fiduciary management' being a very loosely defined term, the key concerns over fiduciary management were associated with value for money and the lack of accountability. One trustee and also a long-standing fund manager has made the following observation in relation to these key issues:

'I have no problem whatsoever with someone becoming my fiduciary, as long as he has [deleted expletive] liability for what he does and, currently, none of them do, so it's not fiduciary; there is no liability. There are no fulcrum fees; if they make money, they collect fees, if they lose money, they don't pay me any back. It should be fiduciary in the real meaning of the word, and the fees should be fulcrum, meaning good times, you make a load of dosh, bad times, they pay it back' (Respondent 8).

It appears that particularly the smaller schemes would give mandates to fiduciary managers and in so doing lose control over the running of the scheme. In terms of oversight, the danger is that fiduciary managers may or may not do a good job because:

'…there's precious little incentive for the fiduciary manager, in terms of oversight, because there's very little going on there to actually do a good job for the client. The conflict is always, "What's best for me?" And this is where people tell me off the record. Actually, now our targets have been moved from treating our customers fairly to actually maximising profit…inside of a fiduciary management contract, it's also a lot harder to swap managers, because you've given away the keys to everything' (Respondent 5).

Such arrangement also has serious implication for ownership:

'Fiduciary management is probably the furthest from proper ownership you can possibly imagine…because everything's bundled up, and what you actually get to see, in the way of ownership of the assets, is tiny. I'm a big, big fan of being able to see what you own. I love this idea of [name of the investment service provider] being able to show me where they're investing my money on a map. Wonderful. That's real. If I want to go and find out where my money's being invested…I don't get any idea about it. I'm not allowed anywhere near the information, really. Or at least it's invested in a fund, which is invested in another fund, which is invested in another fund. And I could get there in the end, but there's so much information and noise, between me and where I want to be. Trustee's, exactly the same. Trustees don't get any ownership of what they want' (Respondent 21).

Several responders, primarily advisors to trustees, have characterised fiduciary service as 'a real mess' because clients are often unclear about what services they are actually buying – an advisory service, a management service, a combination or a project. This is also a model where it is easy to disguise information or present performance information in a way that is not immediately clear and hence harder for trustees to assess. One respondent was able to explain that they chose not to delegate to fiduciary management because all potential contracts excluded any fiduciary liability, which was unacceptable to the fund.

6.6 Discussion of findings from pension fund case study interviews

Our study has set out to broadly review the effectiveness of oversight committees and understand the different influences on investment decision-making. More specifically, we aimed to understand why people agree with others. In the context of heightened academic and policy attention to the effectiveness and accountability of corporate boards (Klein, 2002; Weiss, 2003; Uzun, et. al. 2004; Gaynor, et. al. 2006; Adams and Ferreira, 2007, Rose and Rose, 2008), we aimed to contribute to the scarce literature on the governance of pension funds and the little explored dynamics of trustee oversight and decision-making (Clark, 2004; Clark, et. al., 2006; Clark, et. al. 2007; Clark and Urwin, 2008 and Tilba and McNulty, 2013).

All in all, the existing behavioural biases within trustee boards; complexity and the volume of information that trustees have to work with; the varied levels of investment knowledge and expertise; the opacity of data; the lack of ability to challenge the consultant's advice and monitor the quality of financial services, as well as switching services when needed, seem to be important challenges to effective investment management by pension funds.

Another inhibitor to effective investment decision-making seems to be the conflict of interest between short-term reporting demands that pension fund trustees have and the long-term view that is widely acknowledged to be in the best interest of the fund and in turn, investors/members.

The constraints of so-called 'quarterly capitalism' in which short-term performance appraisals distort effective decision-making for the long-term are well understood to be counter-productive, but are nonetheless difficult to overcome. Trustees have often expressed the frustration at being unable to access the information about their portfolios, or to negotiate with investment consultants and fund managers who are imposing unreasonable terms of contracts on them.

Legal advisors seem to be unable to help as they themselves have little understanding of the investment complexity. There is also evidence to suggest that those advisors who challenge the status quo are often ‘punished’ – for example are being instructed by some investment consultants to perform ‘light touch’ reviews of contractual terms of reference and told that they *‘should not point out all the problems with the fund documents’* using a threat of sending future clients elsewhere.

7 CONCLUSIONS AND RESEARCH LIMITATIONS

7.1 Key findings

The theoretical analysis of insights from behavioural economics and finance suggested that a range of behavioural biases is likely to affect institutional investors' decision-making. The study overall suggests that the key influences likely to be most powerful in the context of institutional investors' asset management include over-confidence; fear of complexity, uncertainty/risk, groupthink, herding and other social influences; and home bias. These factors are likely to exacerbate problems emerging from asymmetric information - including adverse selection, moral hazard and principal agent problems – especially given the complexity of decision-making structures for institutional investment.

This study also suggests that the interests of the often large number of agents (asset managers, investment consultants, trustees, employer) involved in overseeing, managing and implementing institutional investment strategies, are not always aligned with those of the underlying beneficiary. For example, this study highlights that investment consultants may have incentives to recommend over complex strategies or their own asset management products (such as fiduciary management), which serves to help the consultant generate revenue but may not be in the best interests of their clients. In addition, the large number of agents involved in institutional investment can make it difficult for oversight committees to effectively monitor the various agents to ensure value for money for the end-investor.

The online survey finds a, perhaps surprising, degree of trust and satisfaction in the conduct of oversight committee meetings. This could be because these committees actually function well – but could also reflect a degree of complacency, group-think and/or over-confidence

Unlike the online survey the pension funds case study found less satisfaction with how committees function. Here a range of biases and group influences were identified as influencing decision-making on oversight committees and were raised as significant causes for concern by the pension fund trustees interviewed. The discrepancy in findings across these two pieces of analysis under-scores the importance of combining broader but more superficial survey instruments with narrower but more in-depth qualitative interview analyses.

Specifically in the context of the chairing of oversight committee meetings – the online survey suggested that most respondents were happy with the chairing of meetings, whilst the interviews revealed more unease about effective chairing. This corroborates Gregory (2011) who noted that the quality of chairmanship across UK pension fund committees varied from excellent to very poor.

7.2 Limitations and directions for future research

Our study has a number of limitations. The qualitative character of this research means that responses may reflect subjective perceptions and ex-post rationalizations. We have identified inconsistences in comparing online survey responses, which suggested a high degree of satisfaction with decision-making processes, versus interview responses, which illuminated significant concerns about the impact of behavioural bias, herding and groupthink on oversight committee decision-making. One possible explanation for this is a problem of complacency and/or an over-confidence bias from survey respondents, which unravel once decision-making structures are analysed more deeply via one-to-one conversations with individual trustees.

Another possibility is that the samples of respondents from the online survey do not correspond with the sample of interviewees. The online survey responses included trustees from a range of institutional investment funds. The interviews were conducted as part of a case study of pension funds only, and the interviewees were found by targeting a industry group of pension fund transparency activists – these respondents are likely to have self-selected into the lobby group and are likely to share a particular perspective on decision-making within pension fund oversight committees. Unravelling cause and effect in this context is difficult. Have these people joined the lobby group because they have direct experience of some of the problems with pension fund management? Or does membership of the lobby group encourage them to share a particular partial view of the pension fund industry? Many other factors may also play a part in self-reinforcing behaviors.

Further research is needed, for example via a more wide-scale series of interviews and surveys, to establish whether or not pension fund trustees more widely share these concerns. Field and/or experimental studies could also help to establish whether the online survey respondents are over-confident, naïve and/or driven by some form of groupthink in believing that oversight committee decision-making is, generally, quite robust. Further research is also needed, first – to get a more generic and representative sample of interviewees and also to assess via further case studies and surveys whether the insights identified in the pension fund case study will also apply to other institutional investors. Experiments were not feasible for this relatively small pilot study because it takes time and significant resources to construct a robust experimental paradigm. But, with a sufficient number of experimental participants, experimental findings could help us to unravel the different, sometimes superficially contradictory findings from the online survey versus interviews.

7.3 Suggestions for improving Oversight Committee decision-making

In terms of policy implications – some key insights include boosting diversity of membership on oversight committees; re-thinking incentive structures, designing regulatory policies to mitigate impacts from asymmetric information and behavioural bias, and also taking on insights about corporate governance.

7.3.1 Diversity of membership

Diversity of membership is a potential solution to asymmetric information problems. When trustee boards are made up of different types of trustees –including employer-nominated, member or employee-nominated and/or professional trustees – a wide diversity of views will reduce the chances of capture by one particular group or agent. Also, increasing diversity in board membership will be an effective route for constraining the opportunism associated with asymmetric information because a diverse membership will act as a check on group-think and will also increase the chances that the incentives of board members and beneficiaries are aligned, especially if a more diverse board includes ordinary employees as members. Also, a more even gender balance may lead to a reduction in some of the problems of over-confidence, as identified in Section 3.

7.3.2 Incentive structures

Incentive structures for serving on oversight committees could be re-designed to reflect the wide range of incentives and motivations that drive trustees' decision-making. In addition to re-thinking and re-designing the monetary incentives, remuneration structures and opportunity costs associated with participation in pension-fund oversight – introducing innovative non-monetary incentives and motivations, embedding insights from behavioural economics, as well as economics more generally – may help to ensure that members of oversight committees are motivated properly to serve the interests of their end-beneficiaries.

7.3.3 Corporate governance lessons

Investment oversight committees can learn a lot from corporate governance best practice, particularly when it comes to board effectiveness. A way forward would be establishing dedicated governance committees, which would facilitate more focused investment decision-making, better scrutiny of investment advice, and faster responsiveness to investment opportunities.

7.3.4 Education and training

In terms of group dynamics: there is a need to ensure a balanced group of people with the relevant skills are represented on oversight committees. Interviews revealed that often trustee boards do not have people with the relevant skills. Even if there is one person with the relevant skills there is a danger of them unbalancing the group because everyone looks up to them for advice or a 'solution', resulting in herding. It should be incumbent on the chair to make sure that the rest of the board brings the relevant skills and/or that the decision-making committee work together effectively to ensure that, as one interview respondent observed, '*it's not the herd going off in one direction, but that there actually is a meaningful discussion around strategic issues*'.

Policies are needed to ensure that more education and training is provided for lay trustees without much relevant experience or knowledge – to build expertise on committees. One solution to this would be to provide training courses, available in particular for lay trustees. For pension funds, the Pensions Regulator provides an online training tool, but there is no regulatory requirement for pension fund trustees to complete this online training. This potential lack of experience and knowledge must, however, be balanced against the high levels of engagement from lay trustees, who often are more aware of the needs of the pension fund beneficiaries and their incentives are also more likely to be aligned with the wider group of beneficiaries.

7.3.5 Improving information

Trustees and other asset holders should also pay more attention to investment fees and costs, particularly focusing on value for money. Discussions during this project have uncovered a need to focus on the ability to ask the right questions. Transparency and the right to access the information (i.e. better templates and standards on reporting of costs and other data) was also highlighted as a necessity.

There is a need for complete and understandable data. It should be an asset owner's right to obtain the relevant investment data.

7.3.6 Improving regulation

Relating to information points noted above, better information would support investment oversight committees. Regulatory standards should continue to focus on the importance of providing clear, up-to-date information to trustees, with sanctions on lack of transparency, especially from professional advisors. In addition, this would ensure that professional advisors are not able to exploit their informational advantage to the detriment of their clients. Regulatory policies to ensure regular, better performance reporting and more accountability would ensure that incentives of trustees and their agents are more effectively aligned, and would reduce asymmetric information problems, particularly those emerging from moral hazard and costly monitoring.

Minimum regulatory standards are needed to ensure that there is documentary evidence about the competence of trustees on oversight committees, to be able to show that they have a basic understanding of the financial and investment risks, and how to control and mitigate those risks. Regulators could design additional oversight committee protocols specifically to overcome behavioural biases. These could be designed to moderate the pervasive and sometimes detrimental impacts from social influences, herding and group-think, recognizing that uncorrelated and independent decisions from individuals can have more power when pooled than a group decision reached via collective agreement. One way to ensure this might be to have a (perhaps anonymous) voting procedure at the beginning of meetings, before deliberations start.

There are a number of challenges that are harder to address: the multiplicity of various external advisors can work against schemes, particularly if they are small. There is a potentially overwhelming breadth and depth of information available to trustees, who already feel under pressure to keep abreast of regulatory change and new investment products/strategies – so regulatory standards to mitigate against choice overload and information overload could be beneficial.

Generally, there is a wide range of policy solutions and regulatory policies that could be explored though feasibility of implementing these is not assessed in this report.

Further research and evidence is needed, not only in identifying the problems but also in suggesting some effective solutions.

APPENDIX I: SURVEY QUESTIONNAIRE

The questions were formatted/ circulated using Survey Monkey's online survey tool.

1. Name of your organisation
2. What is the primary business of your organisation?
   a. Pension fund/scheme
   b. Charity/endowment fund
   c. Insurance company
   d. Other
3. Your job title:
4. Do you have any relevant qualifications e.g. in finance, accounting, business or economics? If so, please specify:
5. On average each quarter, how often do you attend trustee board oversight committee meetings?
6. What is your role on the oversight committees? e.g. ordinary member, secretary, chair.
7. Do you sit on oversight committees for more than one trustee board?
8. Approximately, how many years have you been a member of trustee board oversight committees?
9. In your experience, do you think oversight committee meetings are chaired effectively on average, so that all members have a chance to contribute to the discussions and deliberations? (Select from "Very effectively" to "Very ineffectively".
10. On average, how much do your judgements/opinions change during oversight committee meetings? Select from "Always" to "Never"
11. Do other oversight committee members listen to you carefully and respect your opinions and judgements? Select from "Always" to "Never"
12. How much do you think others' judgements/opinions change during the course of oversight committee meetings? Select from "Always" to "Never"
13. Do you listen to other oversight committee members carefully and respect their opinions and judgements? Select from "Always" to "Never"

14. During oversight committee meetings, how important are the following factors in influencing your final decision? Score from “Very important” to “Very unimportant”.
    a. New objective evidence/data you haven’t heard/seen before
    b. More persuasive presentations of evidence you have seen before
    c. Opinions of others you know
    d. Opinions of others you trust
    e. Opinions of others with authority
    f. Opinions of others with expertise
    g. Are you influenced by any other factors? If so, please specify the factors and how important they are to your decision-making.
15. In your opinion, during oversight committee meetings how important are the following factors in influencing other members' final decision? Score from “Very important” to “Very unimportant”.
    a. New objective evidence/data they haven’t heard/seen before
    b. More persuasive presentations of evidence they have seen before
    c. Opinions of others they know
    d. Opinions of others they trust
    e. Opinions of others with authority
    f. Opinions of others with expertise
    g. Do you think other members are influenced by any other factors? If so, please specify the factors and how important they are.
16. How much do the following factors limit the effectiveness of individual committee members' decision-making on oversight committees? Score from “Never” to “Always”.

a. Ignorance
b. Overly optimistic judgements of future fund performance
c. Self interest
d. Disproportionate emphasis on potential losses from investment strategies
e. Anxiety
f. Limited financial expertise
g. Advisors/consultants withholding relevant information about different options
h. Overly pessimistic judgements of future fund performance
i. Peer pressure
j. Limited numeracy
k. Over-confidence
l. Judgements based on old evidence instead of current, new information
m. Poor information in general, affecting everyone including advisors/consultants
n. Disproportionate emphasis on potential wins from investment strategies
o. Fear
p. Difficult monitoring the efforts and expertise of advisors/consultants
q. Uncertainty
r. Are any other factors important? Please specify the factor(s) including how much they impact on decisions.

17. Can you think of any other influences that affect decision-making by oversight committees? Please specify/explain.
18. In your experience and on average, for the oversight committees on which you serve, how expert are other committee members in assessing the information presented? Score from “Very expert” to “Very inexpert”
19. In your opinion, on average how robust are the final agreed group decisions made via oversight committees. Score from “Very robust” to “Very unrobust”.
20. If you would like to add any further comments or information about your experiences of decision-making on oversight committees, please elaborate.

APPENDIX II: INTERVIEW PROTOCOL

Interview Protocol

An indication of core themes and questions of the interview

Interview Protocol: My introduction

- Brief introduction of the research project and participant's role in the project
- Ensure confidentiality and anonymity
- Ask permission to audio record the interview
- Let the respondent know that it is possible to stop the recording at any time.
- Discuss briefly the issues that will be covered during the interview
- Any questions?

START RECORDING

Introduction

- Perhaps we can start by you sharing a bit about your background, your role and responsibilities in your organisation.
- How long have you been working here? What did you do before?
- Whom are you working with? What other duties, if any, do you have besides your role

  (For Trustees) Please explain how does your trustee committee work?

Pension fund/ Asset Owner Characteristics and Governance Arrangements

- Can you characterize your fund/organisation? What is the value of the scheme?
- Please give indication of your investment strategy: asset allocation, investment mandates (active/passive; asset classes; in-house/external?)
- In your opinion how do these differences inform the pension fund approach to investment (asset allocation)
- What are the processes, and factors considered, in setting investment objectives and strategies?
- Who oversees your investment strategy?

- Investment decision: Please explain how you procure and monitor your asset management products and services (as well as related services such as those provided by investment consultants)?
- Where in-house asset management teams are used, please explain the rationale for using this approach
- How do you procure and monitor your custodian and other ancillary services?
- Where you procure fiduciary management services, please explain the rationale for using this approach?
- Where you appoint one or more professional trustees to your committee, please explain the rationale for using this approach.
- What are the indicators of good/bad [pension fund/oversight committee] governance?
- How many people are on the Oversight Committee?
- What criteria are used to appoint those who oversee the investment strategy?
- What is the current makeup of the committee in terms of background, experience and qualifications?
- What are the criteria you use to decide upon replacements for members of the committee?
- Does the committee use a Devil's Advocate in decision making?
- Does the committee require unanimous decisions or majority rules?
- Do members criticize others who raise questions concerning a selected solution?
- When new information is contrary to a decision, do members engage in rationalization of the group's earlier decision?
- Do members withhold raising objections in order to maintain unity of the team?
- Are team members reluctant to communicate relevant information?
- How frequently are members of the committee replaced?
- What are the issues of concern to you?

- What are the main challenges for you in making decisions and overseeing the investment strategy?

Expertise

- What is the scope of your understanding of the investment issues?
- Can it be said that trustees' expertise is a source of influence? Do you feel trustees are able to understand investment issues and challenge the advice they are given? [open question]
- What are the indicators of good/poor trustee quality?
- What are the key issues for you there?
- How does the level of trustee's expertise depend on pension fund characteristics?

Other Board Characteristics

- Attitude to teamwork and group conflict
- Strategic Involvement (what are the key strategic issues for you and then your advisors?)
- Frequency of meetings and how meaningful/effective they are
- Please describe your team's decision-making?
- Who steers the meeting's agenda?

Committee Meetings/Board Process

During committee meetings relevant to your professional work:

- Do you think committee meetings are chaired effectively, so that all members have a chance to contribute to the discussions and deliberations?
- How much do your judgements/opinions change during committee meetings?
- Do other committee members listen carefully and respect your opinions and judgements?
- How much do you think others' judgements/opinions change during the course of meetings?
- Do you listen carefully and respect the opinions and judgements of other committee members?
- During meetings, how much do the following factors influence **<u>you</u>**
    - new objective evidence/data you hadn't seen/heard before
    - more persuasive presentation of evidence you have seen before

- opinions of others you know and who they are. For example does your response depend on the type of trustee (e.g. nominated-member, professional trustee); or does it depend on the position of the trustee (e.g. Chair)

- opinions of others you trust and who they are

- opinions of others with authority/seniority and who they are.

- the collective group discussions

- your prior opinions

- other - please elaborate

- During meetings, in your opinion, how much do the following factors influence other members of the committees Rank from 1 - not much; to 5 - a great deal:

  - new objective evidence/data they haven't seen/heard before

  - more persuasive presentation of evidence they have seen before

  - your opinions

  - opinions of those they know and who they are. For example does it depend on the type of trustee (e.g. nominated-member, professional trustee); or does it depend on the position of the trustee (e.g. Chair)?

  - opinions of those they trust and who they are

  - opinions of those with authority/seniority and who they are

  - their prior opinions

  - optimism bias, pessimism bias

  - loss aversion

  - anchoring on past performance

  - emotional biases

  - other - please elaborate

Are decisions objective and based mainly on the information available, or are there any psychological biases when decisions are being made?

How common in your judgement are the following types of bias?

- overly optimistic judgements of future fund performance

- overly pessimistic judgements of future fund performance

- judgements based on old evidence and past forecasts rather than current information

- disproportionate emphasis on potential losses

- disproportionate emphasis on potential gains

- emotional biases, e.g. from fear, greed, anxiety

Can you think of any other influences on group decision-making?

Relationship with an investment consultant

- Do you procure the services of an investment consultant? Which services do you use?
- What choice of investment consultants is there? Who are the main players?
- What are the dynamics of your relationship?
- At what point in discussions do certain recommendations on e.g. active vs passive are made, complex versus simple asset class decisions?
- What does value for money look like to you? Do you think you are getting value for money?
- How confident are you in challenging the investment consultant and/or your investment fund managers? Is it fair to say that the investment consultant may steer the committee to choosing certain asset allocation strategies? If so, how?
- How do you monitor the quality of services provided by your investment consultant?
- How do you evaluate consultants’ advice?
- How frequently do you monitor and evaluate this advice? (Time horizons)
- What is an indicator of good/poor services? What do you do (if anything) in case of unsatisfactory services?

Switching Investment Consultant

- How long have you used your investment consultant?
- Have you ever switched your investment consultant? Why? Was it easy or difficult?
- What are the barriers to switching?

Asset Manager Products and Services

- How do you appoint your asset managers?
- What factors you consider important in appointing an asset manager?
- How do you evaluate the contracts and terms and conditions within your asset managers' mandates?
- At which stage of the tender process do the negotiations on terms of reference happen?
- Do you think you have all the data you need available/disclosed to you?
- Which information were you unable to source ahead of appointing your asset managers?
- Do you understand all the data and terms of references?
- Have you signed any confidentiality agreements on disclosure (e.g. fees and charges?)
- What does good/poor asset management services look like?
- If you are unhappy with your terms and conditions, how confident are you about changing them?
- Can you explain the process of changing the terms of references? Who negotiates on your behalf? (You? Your investment consultant?)

Monitoring of Asset Managers

- How frequently do you monitor your asset managers?
- How do you evaluate asset manager performance?
- How do you 'discipline' your asset managers?
- What is your view on the value for money of your asset managers?

Switching Asset Managers

- How many external asset management firms do you use?
- In the past 5 years, how many times have you switched a manager from the same asset category?
- What are the triggers for switching? Was it easy or difficult?
- What are the barriers to switching?

Fiduciary Management

- Are you aware of any potential conflicts of interest with fiduciary management?
- What steps does the committee take to ensure they are comfortable with delegating fiduciary management?
- Why have you chosen to delegate fiduciary management?

Oversight and Accountability

- In terms of accountability: to whom are you accountable and who do you hold to account when dealing with investment strategy?
- How do you understand fiduciary duty?
- What accountability preferences (if any) are there in the investment chain?
- Can you share your views on characteristics such as Independence, Accuracy/Qualification/Experience, Transparency – within the oversight committee?
- Who else (if at all) should be involved in oversight? (For example, looking at non-traditional players like employees, media, industry regulators)

Overview

- What are the key challenges in your role at the moment?
- What is your perspective on the world of pension funds**/**asset management? How have things changed?
- Where do you see the biggest issues here? How does your fund fit within this context?
- Thinking about asset management and consultancy services, are there any particular aspects that you are not happy about?
- Are there any tensions or potential conflicts of interests or different motivations within this system?
- How does your experience help/hinder you overcoming these challenges?
- What would be the solution to the problem?

Conclusion

- Is there anything else you would like to add? Is there anything that I haven't asked that is important?
- Do you have any questions?
- Thank you for your time.

SWITCH OFF RECORDING

APPENDIX III: PENSION FUND CASE STUDY – LIST OF INTERVIEWEES

Reference	Position(s)	Types of Organisation	Assets under management and/ or client numbers	Industry Sector
Respondent 1	Chairman of Trustees Trustee	Association of Trustees Occupational Scheme	Over £20bn Less than £1bn	Pensions Pensions
Respondent 2	National Officer	Local Authority Scheme	Less than £1bn	Pensions
Respondent 3	Head of DC Pensions	Investment Services to Pension Funds	N/A	Financial Services
Respondent 4	Chairman of Trustees	Occupational Pension Fund	Less than £50mn	Pensions
Respondent 5	Director Actuary	Pensions/Actuarial Consultancy	100 to 500 pension fund clients	Financial Services/ Actuarial
Respondent 6	Chief Executive Chairman of Trustees Independent Trustee	Pension Fund (a) Pension Fund (b) Pension Fund (c)	£1bn to £5bn	Pensions
Respondent 7	Member of Pension Fund Advisory Board Pensions Expert	Local Authority Scheme	£5bn to £20bn	Local Authority
Respondent 8	Head of Research	Financial Advisor	£1bn to £5bn	Financial Services
Respondent 9	Founding Chair	Independent Financial Forum	N/A	Financial Services
Respondent 10	Pensions Advisor	Pension Consultancy	N/A	Pensions and Investment
Respondent 11	Trustee DB Consultant	Pension Administration	100 to 500 institutional clients	Pensions and Insurance
Respondent 12	Head of Consultant Relations Vice President	Financial Advisor	more than £20bn	Financial Services

Reference	Position(s)	Types of Organisation	Assets under management and/ or client numbers	Industry Sector
Respondent 13	Partner Pension Investment Advisor	Law Firm	Large/medium/ Small pension fund clients	Legal Services
Respondent 14	Pensions Investment Expert	Local Authority Scheme	N/A	Pensions
Respondent 15	Partner Independent Director	Occupational Pension Fund	N/A	Pensions
Respondent 16	Financial Expert	International Financial Markets	N/A	Financial Services
Respondent 17	Trustee Advisor Former Member of the Board of Directors	Pension Governance Major Investment Consultancy Firm	Multiple pensions schemes	Pensions
Respondent 18	Director, Head of Strategy	Pensions Research and Management	N/A	Pensions
Respondent 19	Data Vendor	Share Prices and Fund Prices Data Service	N/A	Financial Services
Respondent 20	Barrister	Law Firm	Covers large/medium/ Small pension fund clients	Legal Services
Respondent 21	Trustee	Local government scheme	N/A	Pensions
Respondent 22	Anonymous	N/A	N/A	N/A

REFERENCES

1. Adams, R. B. and Ferreira, D. (2007). A Theory of Friendly Boards. The Journal of Finance, LXII(1): 217-249.
2. Aggarwal, K. and Jorion, P. (2012). Is There a Cost to Transparency? Financial Analysts Journal, 68(2): 108-123.
3. Akerlof G (1970) The Market for "Lemons": Quality Uncertainty and the Market Mechanism, *Quarterly Journal of Economics*, Vol. 84, No. 3 (Aug., 1970), pp. 488-500
4. Akerlof G and Shiller R (2009), *Animal Spirits: How Human Psychology Drives the Economy and Why it Matters for Global Capitalism*, Princeton: Princeton University Press.
5. Ambachtsheer, Keith, Roland Capelle and Scheibelhut, Tom. 1998. 'Improving Pension Fund Performance.' Financial Analysts Journal, (November/December): 15-21.
6. Anderson L and Holt C (1996). Classroom Games: Information Cascades, Journal of Economic Perspectives, vol. 10(4), pp. 187-93.
7. Ariely D (2008) *Predictably Irrational – the Hidden Forces that Shape Our Decisions*, New York: Harper Collins.
8. Arthurs, J. D., Hoskisson, R. E., Busenitz, L. W., and Johnson, R. A. (2008). Managerial Agents Watching Other Agents: Multiple Agency Conflicts Regarding Uderpricing in IPO Firms. Academy of Management Journal, 51(2): 277-294.
9. Asch, S. E. (1955). Opinions and social pressure. Scientific American, 31-35.
10. Asch, S. E. (1956) Studies of independence and conformity: A minority of one against a unanimous majority. Psychological Monographs 70 Whole no. 416.
11. Baddeley (2010) Emotions, herding, neuroscience etc. Phil Trans Royal Society.
12. Baddeley (2013a) Behavioural Economics and Finance, Abingdon: Routledge.
13. Baddeley (2013b) Herding, social influence and expert opinion, Journal of Economic Methodology, vol. 20(1), pp. 35-44.
14. Baddeley M (2016a) *Behavioural Economics – A very short introduction*, Oxford: Oxford University Press.
15. Baddeley M (2016b), Housing Herding - A Behavioural Experimental Analysis,

https://www.researchgate.net/publication/306940796_Housing_Herding_a_Behavioural_Experimental_Analysis.

16. Baddeley M and Parkinson S (2012), Group decision-making: An economic analysis of social influence and individual difference in experimental juries, The Journal of Socio-Economics, 41(5): 558-573.
17. Bader N. and Gold, J. (2007). The Case Against Stock in Public Pension Funds, Financial Analyst Journal, 63(1): 55-62.
18. Banerjee A. (1992). A Simple Model of Herd Behavior, Quarterly Journal of Economics, vol. 107(3), pp. 797-817
19. Barber, B.M. and Odean, T. (2001). Boys Will be Boys: Gender, Overconfidence, and Common Stock Investment. Quarterly Journal of Economics. 116(1): pp261-292.
20. Bateman, H. G., Kingston, G., and Piggot, J. 2001. Forced Saving: Mandating Private Retirement Incomes. Cambridge: Cambridge University Press.
21. Bauer, R., Cremers, M. & Frehen, R. G. 2010. Pension Fund Performance and Costs: Small is Beautiful, s.l.: CEM Benchmarking.
22. Bernatzi S and Thaler R (1995), Myopic loss aversion and the equity premium puzzle, *Quarterly Journal of Economics*, 110 (1): 73-92.
23. Bikhchandani, S, Hirshleifer, D, Welch, I (1992). A theory of fads, fashions, custom and cultural change as informational cascades, Journal of Political Economy, vol. 100(5), pp. 992-1026.
24. Bikhchandani, S, Hirshleifer, D, Welch, I (1998), Learning from the Behavior of Others: Conformity, Fads, and Informational Cascades, Journal of Economic Perspectives, Vol. 12, No. 3, pp. 151-170.
25. Bikker, J. 2013. Is there an optimal pension fund size? A scale-economy analysis of administrative and investment costs'. DNB Working Paper, No. 376, (April).
26. Bikker, J. A., Steenbeck, O. W. and Torracchi, F. (2012). The Impact of Scale, Complexity, and Service Quality on the Administrative Costs of Pension Funds: A Cross-Country Comparison. The Journal of Risk and Insurance, 79(2): 477-514.
27. Blake, D. (1995). Pension Schemes and Pension Funds in the United Kingdom. Oxford: Clarendon Press.

28. Blake, D. (2003). "UK Pension Fund Management after Myners: the Hunt for Correlation Begins." Journal of Asset Management 4(1): 32-72.
29. Bogle, John. 2014. 'The Arithmetic of 'All-In' Investment Expenses.' Financial Analysts Journal, Vol. 70, no. 1: 13-21.
30. Brikker, Jacob. and De Dreu, Jan. 2009. 'Operating Costs of Pension Funds: the Impact of Scale, Governance and Plan Design'. Journal of Pension Economics and Finance, Vol. 8, no.1 (January): 863-89.
31. Brinson, G., Hood, L. and Beebower, G. 1986. 'Determinants of Portfolio Performance'. Financial Analysts Journal, (July-August): 231-262.
32. Buse, K., Bernstein, R. S. and Bilimoria, D. (2016). The Influence of Board Diversity, Board Diversity Policies and Practices, and Board Inclusion Behaviors on Nonprofit Governance Practices. J Bus Ethics, 133: 179-191.
33. Busse, J., Goyal, A. and Wahal, S. 2010. 'Performance Persistence in Institutional Investment Management', Journal of Finance, Vol. 65: 765-790.
34. Carhart, Mark M. 1997. 'On Persistence in Mutual Fund Performance'. The Journal of Finance, Vol. LII, no. 1 (March): 57-82). 'The Determinants of the Flow of Funds of Managed Portfolios: Mutual Funds vs. Pension Funds.' Journal of Financial an Quantitative Analysis, Vol. 37, no. 4 (December): 523-557.
35. Carter, D. (2009). "Equity Investments Getting the Cold Shoulder in Europe." Pensions & Investments 37(12): 6-29.
36. Chan, L., Chen, H, and Lakonishok, J. 2002. 'On Mutual Fund Investment Styles'. Review of Financial Studies, Vol. 15: 1407-1437.
37. Chen, G., Kriz Kenneth and Ebdon, C. (2015). The Effect of Board Composition on Public Sector Pension Funding. Journal of Public Budgeting, Accounting & Financial Management, 27(3): 352-376.
38. Christoffersen, Susan E.K. and David K. Musto. 2002. 'Demand Curves and the Pricing of Money Management.' Review of Financial Studies, Vol.15: 1495-1524.
39. Clark, G. (2004). "Pension Fund Governance: Expertise and Organizational Form." Journal of Pension Economic and Finance 3(2): 233-253.
40. Clark, G. and Urwin, R. (2008). "Leadership, Collective Decision-Making, and Pension Fund Governance." SSRN Papers,

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1133015 [accessed: 20 March 2009].

41. Clark, G., Carlewy-Smith, E. and Marshall, J. C. (2006). "Pension Fund Trustee Competence: Decision-Making in Problems Relevant to Investment Practice. " Journal of Pension Economic and Finance 5(1): 91-110.
42. Clark, G., Carlewy-Smith, E. and Marshall, J. C. (2007). "The Consistency of UK Pension Fund Trustee Decision-Making. " Journal of Pension Economic and Finance 6(1): 67-86.
43. Cocco, J.F. and P.F. Volpin (2007). "Corporate Governance of Pension Plans: the U.K. evidence. " Financial Analysts Journal 63(1): 70-83.
44. Conyon, M. J., Peck, S. I. and Sadler G. V. (2009). Compensation Consultants and Executive Pay: Evidence from the United States and the United Kingdom. Academy of Management Perspectives, 23(1):43-55.
45. Cox, P., S. Brammer, and Millington, A. (2007). "Pension Fund Manager Tournaments and Attitudes Towards Corporate Characteristics." Journal of Business Finance & Accounting 34(7) & (8): 1307-1326.
46. Creswell, J.W. (2007) Qualitative Inquiry & Research Design: Choosing among Five Approaches. 2nd edition, Sage.
47. Dacin, T., Munir, K. and Tracey, P. (2010). ‘Formal Dining at Cambridge Colleges: Linking ritual performance and institutional maintenance’, Academy of Management Journal, 53, pp. 1393-1418.
48. Del Guercio, D. and Tkac, P. A. (2002). The Determinants of the Flow of Funds of Managed Portfolios: Mutual Funds vs. Pension Funds. The Journal of Financial and Quantitative Analysis, 37(4): 523-577.
49. Department of Social Protection, 2012. Report on Pension Charges in Ireland 2012.
50. Dyck, A. and Pomorski, L. 2011. ‘Is Bigger Better? Size and Performance in Pension Plan Management’, https://wpweb2.tepper.cmu.edu/wfa/wfasecure/upload2011FINAL/2011_PA_207786_384586_979145.pdf
51. Easterby-Smith, M., Thrope, R. and Lowe, A. (2002). Management Research An Introduction. London, Thousand Oaks, New Delhi: SAGE Publications.

52. Edwards, A. K., Harris, L. E. and Piwowar, M. S. (2007). Corporate Bond Market Transaction Costs and Transparency. The Journal of Finance, LXII(3): 1421-1451.
53. Eisenhardt, K.M. (1989). 'Building Theories from Case Study Research', Academy of Management Review, 14, pp. 532-550.
54. Ellis, Charels D. 2012. 'Investment Management Fees Are (Much) Higher Than You Think.' Financial Analysts Journal, vol. 68, no.3 (May-June):4-6.
55. Elton, Edwin, J., Martin J. Gruber and Christoper R. Blake. 2006. 'Participant Reaction and the Performance of Funds Offered by 401(k) Plans.' Journal of Financial Intermediation, Vol. 16: 249-271.
56. Engaged Investor (2013). Male, Pale and Stale. Retrieved on 17/06/2016, from: http://www.engagedinvestor.co.uk/Journals/2013/05/30/v/z/m/Male-pale-and-stale.pdf
57. Erta K, Hunt S, Iscenko Z, and Brambley W (2013), Applying behavioural economics at the Financial Conduct Authority, FCA Occasional Paper No.1, London: Financial Conduct Authority.
58. Faccio, M. and Lasfer, A. (2000). "'Do Occupational Pension Funds Monitor companies in Which They Hold Large Stakes " Journal of Corporate Finance 6: 71-110.
59. Fama, E. F. (1980). "Agency Problems and the Theory of the Firm." The Journal of Political Economy 88(2): 288-307.
60. Financial Conduct Authority (2015). *Asset Management Market Study Terms of Reference.* Retrieved on 12/07/2016, from: http://www.fca.org.uk/static/documents/market-studies/ms15-02-1.pdf
61. Finkelstein, S. and Mooney, A. (2003). Not the Usual Suspects: How to Use Board Process to Make Boards Better. The Academy of Management Executive, 17(2): 101-113.
62. Frederick S, Loewenstein G and O'Donoghue T (2002) 'Time Discounting: A Critical Review', Journal of Economic Literature, vol. 40(2), pp. 351-401.
63. Frynas, J. G. (2010). Corporate Social Responsibility and Societal Governance: Lessons from Transparency in the Oil and Gas Sector. Journal of Business Ethics, 93: 163-179.

64. Gaynor, L. M., Daniel, L. S., and Neal, T. L. (2006). The Effects of Joint Provision and Disclosure of Nonaudit Services on Audit Committee Members' Decisions and Investors' Preferences. The Accounting Review, 81(4): 873-896.
65. Glaser, B. G. (1978). Theoretical Sensitivity: Advances in the Methodology of Grounded Theory. Mill Valley, Ca.: Sociology Press.
66. Gov.uk (2014). Fund Management in the UK. Retrieved on 18/06/2016, from: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/478378/UKTI_Asset_mgmt_broch_B5_RC_AW_DIGIAL.pdf
67. Gregory, A. (2011). Effective Oversight of Pension Administration in Good Governance for Pension Schemes, eds. Thornton P. and Fleming D. University Publishing Online.
68. Gruber, M. 1996. 'Another Puzzle: The Growth in Actively Managed Mutual Funds'. Journal of Finance, Vol. 51: 783-810.
69. Gümbel, A. (2005). "Herding in Delegated Portfolio Management: When is Comparative Performance Information Desirable?" European Economic Review 49: 599-626.
70. Haldane, A. (2010). Patience and Finance. Oxford China Business Forum, Beijing.
71. Haldane, A. and Davies, R. (2011), 'The Short Long', 29th Société Universitaire Européene de Recherches Financiéres Colloquium: New Paradigms in Money and Finance? Brussels.
72. Harper, J. T. (2008). Public Sector Pension Governance in the United States: Up to the Task? *Rotman International Journal of Pension Management, 1(1),* pp. 22-28
73. Haslem, John A.A. 2004. 'Are Mutual Fund Expenses too High? A Commentary'. Journal of Investing, 9Fall): 8-12.
74. Hazenberg, J. J. (2016). Independence and Focus of Luxembourgh UCITS Fund boards. Eur J Law Econ, 41: 117-155.
75. Hebb, T. (2006). The Economic Inefficiency of Secrecy: Pension Fund Investors' Corporate Transparency Concerns. Journal of Business Ethics, 63: 385-405.
76. HM Treasury (2001). Institutional Investment in the United Kingdom: A Review. Retrieved on 19/06/2016, from: http://uksif.org/wp-

content/uploads/2012/12/MYNERS-P.-2001.-Institutional-Investment-in-the-United-Kingdom-A-Review.pdf

77. HM Treasury (2004). Myners Review of the Governance of Life Mutuals – Final Report.
78. HM Treasury (2008). Updating Myners Principles
79. http://www.pensionprotectionfund.org.uk/Pages/ThePurpleBook.aspx]
80. Ibbotson, R. G. and Kaplan, P. D. (2000). Does Asset Allocation Policy Explain 40, 90 or 100 Percent of Performance? Financial Analyst Journal, 56(1):26-33.
81. Institute for Government, Cabinet Office (2010), MINDSPACE – Behavioural Economics, London: Institute for Government.
82. Investment Management Association (2014). Asset Management in the UK 2013-2014. Retrieved on 18/06/2016, from: http://www.theinvestmentassociation.org/assets/files/research/2014/20140909-IMA2013-2014-AMS.pdf
83. Jenkinson, T., Jones, H. and Martinez, J.V. (2016), Picking winners? Investment consultants' recommendations of fund managers, *Journal of Finance*, vol. 71(5), pp. 2333–2370.
84. Jensen, M. C. and W. H. Meckling (1976). "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure." Journal of Financial Economics 3(4): 305-360.
85. Kahneman (2011), *Thinking, Fast and Slow*, London: Allen Lane.
86. Kahneman D and Tversky A (1979), 'Prospect Theory -An Analysis of Decision under Risk'', Econometrica, vol. 47, no. 2, pp. 263-292.
87. Kahneman D, Slovic P and Tversky A (1982)(eds), *Judgement Under Uncertainty: Heuristics and Biases*, Cambridge: Cambridge University Press
88. Kahneman and Tversky (1984) Choices, values and frames, *American Psychologist*, vol. 39(4), pp. 341-50.
89. Kakabadse, N. and Kakabadse, A. (2004) "Pension fund Governance: An Overview of The Role Of Trustees." International Journal of Business Governance and Ethics, 1, 1:3-26.
90. Kakabadze, N., Kakabadze, A. and Kouzmin, A. (2003). Pension Fund Trustees: Role and Contribution. European Management Journal, 21(3): 376-386.

91. Keynes J. M. 1936. The General Theory of Employment, Interest and Money. London: Macmillan / Royal Economic Society.
92. Keynes J. M. 1937. The General Theory Of Employment. Quarterly Journal of Economics, vol. 51, 209-223.
93. Kinnel, Russel. 2010. Morningstar FundInvestor, vol. 18, no.12 (August):1-3.
94. Klein, A. (2002). Economic Determinants of Audit Committee Independence. The Accounting Review, 77(2): 435-452.
95. Laibson, D., 1997. Golden eggs and hyperbolic discounting. Quarterly Journal of Economics 112,443–478.
96. Laibson D, Repetto A, Tobacman J (2007), Estimating discount functions with consumption choices over the lifecycle, NBER Working Paper 13314, Cambridge MA: National Bureau of Economic Research.
97. Law Commission (2013). Fiduciary Duties of Investment Intermediaries: Initial Questions [available at: http://lawcommission.justice.gov.uk/docs/fiduciary_duties_short_May2013.pdf]
98. Law Commission (2014). Fiduciary Duties of Investment Intermediaries: The Final Report https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/325508/41342_HC_368_LC350_accessible.pdf]
99. Leibenstein 1976, Beyond Economic Man, Cambridge: Harvard: University Press
100. Leibenstein H (1950), "Bandwagon, Snob and Veblen Effects in the Theory of Consumer Demand", Quarterly Journal of Economics, Vol.64 No.2 : Page 183-207
101. Lincoln, Y.S. and Guba, E.G. (1985). 'Naturalistic Inquiry'. Beverly Hills, Ca: Sage.
102. Loomes G and Sugden R (1982) Regret theory: an alternative theory of choice under uncertainty, Economic Journal, vol. 92(368), pp.805-824.
103. Malkiel, B. 1995. 'Returns from Investing in Equity Mutual Funds 1971-1991'. Journal of Finance, Vol. 50: 549-572.
104. Marino, A. M. and Matsusaka, J. G. (2005). Decision Processes, Agency Problems, and Information: An Economic Analysis of Capital Budgeting Procedures. The Review of Financial Studies, 18(1): 301-325.

105. Milgram, S. (1963) 'Behavioral study of obedience.' Journal of Abnormal and Social Psychology. 67. p371–8.

106. Muth, J.F. (1961) ‘Rational Expectations and the Theory of Price Movements’, Econometrica, 29(3), 315-335.

107. Myners Report (2001). Institutional Investment in the United Kingdom: A Review. London: HM Treasury, United Kingdom.

108. NAPF (2007). Institutional Investment in UK: Six Years On. http://napf.co.uk [accessed 14 April, 2008].

109. OECD (2015). Table 1: Financial Assets of Institutional Investors, 2014. [available at: http://www.oecd-ilibrary.org/finance-and-investment/oecd-institutional-investors-statistics-2015/financial-assets-of-institutional-investors-2014-united-kingdom_instinv-2015-table118-en]

110. Office of Fair Trading (2013), Defined Contribution Workplace Pension Market Study, London: Office of Fair Trading [available at: http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505]

111. Payne, B. (2002). "U.S. Equity Allocations on the Rise Among U.K. Pension Plans.” Pensions & Investments 30(3): 2

112. Pensions Act (1995). Codes of Practice. Department for Work and Pensions.

113. Pensions Act (2004). Codes of Practice. Department for Work and Pensions.

114. Purple Book, 2009. Pensions Protection Fund.

115. Purple Book, 2014. Pension Protection Fund.

116. Pitt-Watson, D., C. Sier, S. Moorjani and H. Mann (November 2014), ‘Investment costs: An unknown quantity. A literature review and state of play analysis’ http://www.fscp.org.uk/publications/pdf/investment_%20david_pitt_%20watson_et_al_final_paper.pdf.

117. Rose, A. M. and Rose, J. M. (2008). Management Attempts to Avoid Accounting Disclosure Oversight: The Effects of Trust and Knowledge on Corporate Directors’ Governance Ability. Journal of Business Ethics, 83(2):193-205.

118. Securities and Exchange Commission SEC (2005), Performance and Accountability Report, US Securities and Exchange Commission. http://www.sec.gov/about/sectpar20015.pdf

119. Shah, S.K. and Corley, K. G. (2006). 'Building Better Theory by Bridging the Quantitative-Qualitative Divide', Journal of Management Studies, 48, pp. 1821-1835.

120. Sharpe, William, 2013. 'The Arithmetic of Investment Expenses.' Financial Analysis Journal, vol69, no.2: 34-41.

121. Simon, H (1955) 'A behavioural model of rational choice', Quarterly Journal of Economics, vol. 69, pp. 99-118.

122. Societe Generale Cross Asset Research (2008). Mind Matters. The Road to Revulsion and the Creation of Value. 25 November 2008

123. Statista (2016). Number of Mutual Funds in Selected Countries Worldwide from 2011 to 2014. [available at: http://www.statista.com/statistics/331922/number-mutual-funds-worldwide/]

124. Stephens, N. (2007). "Collecting data from elites and ultra elites: telephone and face-to-face interviews with macroeconomists." Qualitative Research 7: 203-216.

125. Sullivan, R. (2008). "Pension Funds Slow to Diversify." Financial Times June 2, p. 10.

126. Surowiecki, J. 2004 The wisdom of crowds: why the many are smarter than the few. London: Abacus.

127. Tapia, Valdo and Yermo Juan, 2008. 'Fees in Individual Account Pension Systems. A Cross-Country Comparison'. OECD Working Papers on Insurance and Private Pensions, No. 27, OECD publishing.

128. Thaler R and Sunstein C (2008), *Nudge – Improving Decisions about Health, Wealth and Happiness*, Yale: Yale University Press.

129. Thaler R T (2015), *Misbehaving – the Making of Behavioural Economics*, London: Allen Lane.

130. Thaler R (2005) *Advances in Behavioral Finance*, Princeton: Princeton University Press.

131. Tilba, A and McNulty, T. (2013). 'Engaged versus Disengaged Ownership: The Case of Pension Funds in the UK', Corporate Governance: An International Review, 21, pp. 165–182.

132. Tilba, A. (2011). Pension Fund's Investment Practice and Corporate Engagement. PhD Thesis, University of Liverpool Management School, 126.

133. Tomorrow's Owners (2008). "Stewardship of Tomorrow's Company." Tomorrow's Company Report.

134. Tonks, I. (2005). Performance Persistence of Pension Fund Managers. Journal of Business, 78(5): 1917-1942.

135. Tversky, A. & Kahneman, D (1974). Judgement under uncertainty: heuristics and biases. Science, 185, 1124-1131.

136. Tversky, Amos and Kahneman, Daniel, "Judgment under uncertainty: Heuristics and biases," Science, 185 (1974), 1124-1131.

137. Uzun, H., Szewczyk, S. H. and Varma, R. (2004). Board Composition and Corporate Fraud. Financial Analyst Journal, 60(3): 33-43.

138. Vanguard (2014). Global Equities: Balancing Home Bias and Diversification. [https://www.vanguard.com/pdf/ISGGEB.pdf]

139. Webb, D. C. (2007) Sponsoring Company Finance, Investment and Pension Plan Funding. The Economic Journal, 117(520): 738-760.

140. Weiss, E. (2003). Some Thoughts on an Agenda for the Public Company Accounting Oversight Board. Duke Law Journal, 53(2):491-515.

141. Wylie, S. (2005). "Fund Manager Herding: A Test of the Accuracy of Empirical Results Using U.K. Data." Journal of Business 78(1): 381-403.

142. Yang, T. and Mitchell, O. (2005). Public Pension Governance, Funding and Performance: A Longitudinal Appraisal, Pension Research Council.