

Return Of The Pension Investment Fiduciary



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Current Challenges:

With the globalization of capital markets over the last few decades, there has been a marked increase in the range and complexity of investment opportunities available to investors. In fact, the array of investment options available today is virtually limitless: stocks, bonds, mutual funds, pool funds, hedge products, structured products, private equity, income trusts, real estate, master limited partnerships and commodities. The result of this trend has been an increase in the number of investment related participants, which has ironically led to increased levels of complexity for Pension Plans.

Additionally, with the increased marketing and product focus touted by an expanding marketplace, Sponsor focus has been led away from the real need to meet “*consumption goals*” (ie: current and future pension disbursements/benefits) to that of relative performance, based upon market or peer indices. This has resulted in managers being traded like commodities, and Corporate Sponsors and their Advisors attempting to maximize relative performance. It is our view that the focus on superior relative performance, instead of the future consumption requirements of each plan, has been a major contributor (beyond the general rise in liabilities due to declining interest rates) to underfunded Pension Plans.

What Are Pension Sponsors Seeking?

All of these issues, in combination with the ongoing challenging capital market conditions of the past decade, are causing many Pension Sponsors and their Boards to increasingly search for true professional support in the management and oversight of the wealth entrusted to them. Informed Sponsors are more and more realizing that their Pension Plans are more than simply ‘*pools of capital*’ but actual ‘Asset Management Businesses.’ As such, they need to be operated in a disciplined manner where assets, liabilities, revenues and expenses are all managed in a prudent manner. It is our experience that Sponsors and their Boards/Investment Committees are desperately seeking someone who will:

- Provide real advice, not just a list of manager/product recommendations,
- Be objective in the advice provided,





- Be accountable (both ethically and legally) for the advice that they provide,
- Collaborate with the Sponsor, Board/Investment Committee and other professionals, such as actuaries, to create real sustainable solutions to their pension business problems,
- Not ‘*blow smoke at them*’ by pitching new investment fads and trends as a purported ‘*high return*’ solution to their challenges, and,
- Provide full transparency of all investment related fees and expenses.

Given these requirements, we believe that the way forward for Pension Plans is to return to the roots of the asset management industry: *The Investment Fiduciary*.

The Investment Fiduciary

We view a ‘*fiduciary*’ as someone who acts in a position of trust on behalf of, or for the benefit of, a third party. For this reason, an investment fiduciary is typically held to a higher standard of care than someone who is not a fiduciary. A true Investment Fiduciary is not someone selling a product or a consultant providing a list of suggestions and recommendations....they are providing real and objective advice which they are ethically and legally bound to provide

The Outsourced Chief Investment Officer

In Europe, especially the Netherlands, the use of **Fiduciary Managers**, also known as **Outsourced Chief Investment Officers (CIOs)**, is a rapidly growing business. McKinsey & Company indicates that in the Netherlands, the market for Fiduciary Management was 50 Billion Euros as of the end of August 2006. As outlined in his book, **Fiduciary Management: Blueprint For Pension Fund Excellence**, Anton van Nunen describes how the prevailing investment management structures for pension funds were established such that “*too many people had a role while no one had overall responsibility*”. While the Sponsor Organization retains ultimate accountability for the Plan the Outsourced CIO, is responsible for the day-to-day management of the wealth according to six areas:

1. Asset-Liability Matching:

The central theme to embarking on an asset liability study is to establish a well-funded position. Achieving a well-funded position results in lower expected future costs for contributors, and protects beneficiaries.



2. Risk and Return Analysis:

An Outsourced CIO will work in partnership with a firm's actuary and/or other professionals to analyze and illustrate the impact of investment policy decisions in a framework that links funding and risk and return analysis with investment policy.

3. Portfolio Construction:

A portfolio's behavior over time, and through various market cycles, is at least as important as the longer term returns that it generates. Also, while a particular portfolio structure may prove beneficial over time, if the Plan Sponsor is unable to tolerate shorter-term volatility then counterproductive decisions may be made. As a result, without appropriate portfolio structuring, inappropriate actions can be taken at times of fear (when markets are financially dislocated) or optimism (when markets are overvalued). Similarly, constant manager turnover has a negative financial effect to the overall investment program.

4. Selecting and Overseeing Investment Managers:

Pure mathematical methods for selecting future winning investment managers have proven to be less than reliable. As the commonly used disclaimer in the investment management business states, *"past performance is not necessarily indicative of future returns"*. Additionally, with the rise of global volatility in capital markets, prudent and effective manager due diligence is critical to protecting client assets.

While there is no perfect predictor, our experience has proven to us that it is the rigour of the process and the experience of the people that will most significantly influence future investment success. That is why we believe in the blending of prudent performance analysis with a heavy dose of qualitative research – and a strong focus on the latter.

5. Measuring and Reporting Portfolio Results To Sponsor:

The breadth, complexity and continuous evolution of investment instruments and investment strategies, coupled with increased regulatory scrutiny and market volatility, make comprehensive data, modeling, and analytics more important than ever. Accurate, timely information that clearly illustrates the drivers of performance against each plan's unique set of goals and risk tolerances is a must. Just as important is the experienced evaluation of these factors to ensure customized answers to complex pension challenges.



6. Education of Plan Sponsors and Investment Committees:

As most Plan Sponsor Executives and Investment Committee members are not practicing investment professionals, it's imperative that true Outsourced CIOs provide ongoing educational support to their pension clients in order to enable them to make better informed decisions around the strategic management of their plans. Based upon the belief that Pension Plans are best viewed as *'businesses'* instead of simply *'pools of capital'*, the Outsourced CIO should be a key strategic member of the overall management team of the 'Pension Business' instead of merely a seller of product or consultant of manager search services.

By executing successfully in these six areas, the Outsourced CIO *"reunites expertise and responsibility"* with the Sponsor organizations.

Benefits Of An Outsourced CIO

An Outsourced CIO provides clients with the following benefits:

1. Comprehensive and Integrated Advice:

The advice provided by an Outsourced CIO spans the full spectrum of the asset management function – policy, management and review – but is accomplished within an integrated approach to goals-based portfolio construction, while stewarded with a fiduciary mindset

2. Ongoing Relationship:

Outsourced CIOs typically have an ongoing professional relationship with their clients. As a result, they are available for ongoing dialogue with their clients and not only when investment manager changes are required.

3. Unwavering Objectivity:

Most Outsourced CIOs do not have their own proprietary investment products that they provide to clients. As a result, the investment solutions and services that they provide to their clients are fully objective and delivered with the client's best interest in mind at all times.

4. Shared Responsibility:

We believe that Plan Sponsors do not want to bear the burden of full responsibility for every investment solution implemented – although they are clearly accountable. Instead, we believe that Sponsors expect their professional advisors to share that responsibility. An Outsourced CIO provides clear advocacy of all proposed solutions.



5. Value:

Given the ongoing nature of the Outsourced CIO relationship, Pension Plans are typically provided with solid value as the costs of CIO services are normally amortized over the full-term of a multi-year professional services agreement instead of being compacted into a series of one-off consulting engagements for manager search and due diligence assignments or hidden in proprietary investment products.

We believe that the Pension Plans will be better served if they seek support from professionals who do more than investment manager search and due diligence, but see themselves as Outsourced CIOs and have adopted a Fiduciary Manager Approach. In doing so, we believe that Sponsors will be far more successful in fulfilling their fiduciary obligations in a world in which global investment opportunities simultaneously exist with new and ever changing risks .

Future Of The Investment Fiduciary

In Canada, we have always known specific asset management roles – such as trustees and discretionary investment money managers — to be fiduciaries. Other advice and or service providers operate from a significantly lower standard of legal liability. With the rising standards of care demanded by both clients and regulators, the Fiduciary Manager or Outsourced CIO, as a professional solution to pension industry challenges, is rightfully receiving growing attention in the industry.