

Governance Review Workshop

Public Service Pension Fund Supervisory Board

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Towers Watson's definition of governance

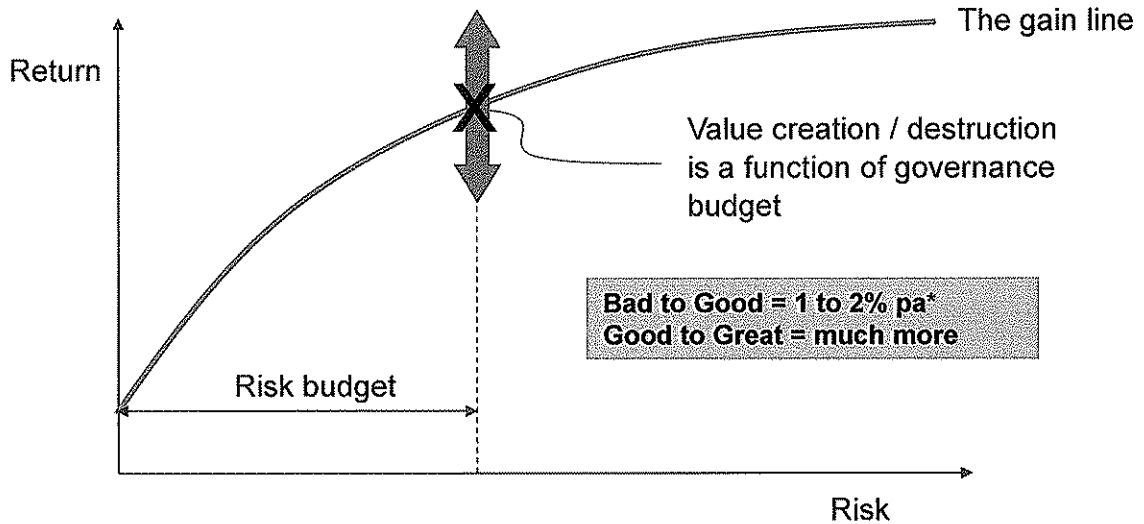
- Governance budget refers to the capacity to create value from effective actions in the chain of defined tasks and functions.

Governance = Organisational coherence x People x Process

Governance Budget		
<p>Organizational Coherence</p> <p>This refers to the coherence between the structure of the fund and the long-term interests of the fund.</p>	<p>People</p> <p>This refers to the people involved in the investment process, their skills and responsibilities.</p>	<p>Process</p> <p>This refers to how investment decision-making is managed and implemented</p>

Why is governance important?

- Governance drives wealth creation.
- The governance budget determines how successful the risk budget is deployed.
- Investment arrangements should be aligned with the Fund's governance capabilities.



* Source: Ambachtsheer letter, Towers Watson

Global Best Practice

Mission clarity, beliefs and risk budget are core attributes

- The Clark-Urwin governance study* found that the best-practice exemplar funds made frequent references to their adherence to a number of core principles which we can summarise in the six attributes below.
- Strong beliefs is amongst these core attributes
- We regard the 'Strong beliefs' attribute as one of the most critical to effective governance

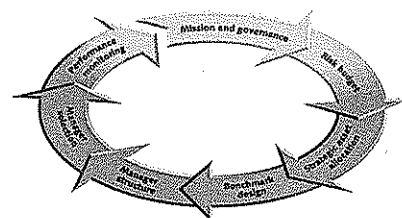
Area	Core best practice factors	
Coherence	Mission clarity	Clarity of the mission and the commitment of stakeholders to the mission statement
	Effective focusing of time	Resourcing each element in the investment process with an appropriate budget considering impact and required capabilities
People	Leadership	Leadership, being evident at the Board/Investment Committee level, with the key role being the Investment Committee chairman
	Strong beliefs	Strong investment beliefs commanding fund-wide support that align with goals and inform all investment decision-making
Process	Risk budget framework	Frame the investment process by reference to a risk budget aligned to goals with an accurate view of alpha and beta
	Fit-for-purpose manager line-up	The effective use of external managers governed by clear mandates, aligned to goals, selected on fit-for-purpose criteria

* See Best-practice investment management: lessons for asset owners from the Oxford-Watson Wyatt project on governance, Gordon L. Clark (Oxford University) and Roger Urwin

Why investment decisions require beliefs

- Beliefs are used extensively by funds already...but in an unstructured way
 - Investment decisions are complex with massive data overload so we need beliefs
 - But most beliefs are based on personal experience and opinion
 - Joint decisions reflect multiple opinions at multiple levels
 - Given the large amount of information potentially relevant to investment decisions, beliefs are essential to allow investment committees to avoid paralysis via information overload.
- The process of specifying beliefs also allows for boards to be more coherent and logical in their decisions.
- **With structured beliefs...**
 - Time is saved/ deeper treatment is given to complex decisions
 - Thinking and research can build a strong competitive base to beliefs
 - Beliefs can be layered – executive level/ board level – and gaps limited

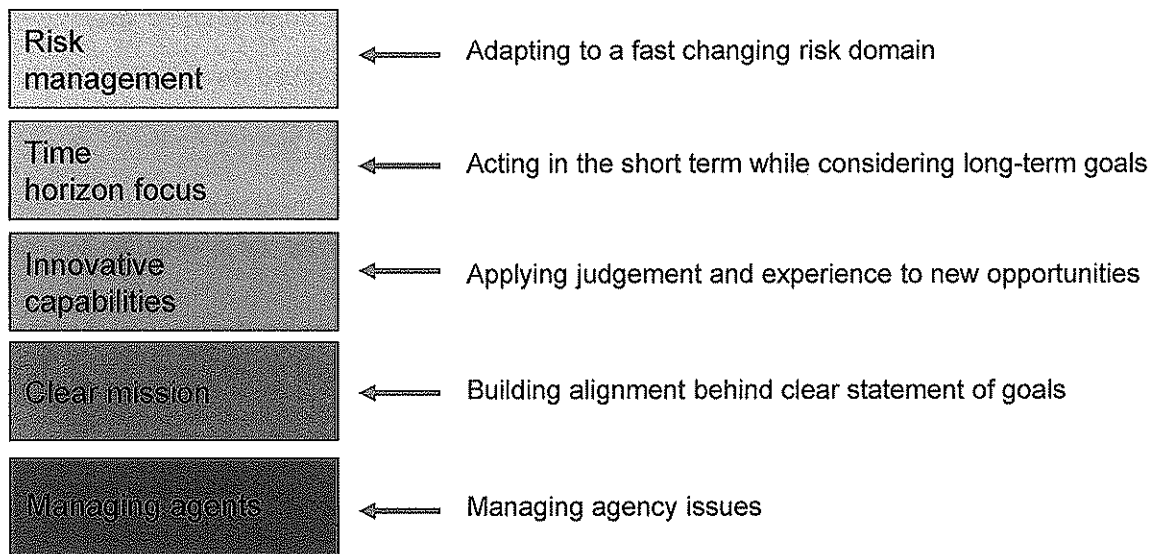
Beliefs are required in four areas



- Today's belief setting process will cover four areas

Key Areas for Positions / Beliefs	Detail	Decision level
Mission and goals	<ul style="list-style-type: none"> ◦ Include consideration of optimal risk exposure and time horizon given stakeholder considerations 	Top level
Governance	<ul style="list-style-type: none"> ◦ What resources and processes are used in decision-making – to fulfil the mission 	
Asset allocation and beta	<ul style="list-style-type: none"> ◦ Include consideration of asset class pricing and mispricing and how the fund might exploit these beliefs 	Second level
Managers and alpha	<ul style="list-style-type: none"> ◦ Include beliefs about the conditions in which active management can add value 	

5 main challenges that best practice funds must surmount



Global best-practice – core attributes

- The best-practice exemplar funds made frequent references to their adherence to a number of core principles which we can summarise in the six attributes below.

Core best-practice factors		
Coherence	Mission clarity	Clarity of the mission and the commitment of stakeholders to the mission statement
	Effective focusing of time	Resourcing each element in the investment process with an appropriate budget considering impact and required capabilities
People	Leadership	Leadership, being evident at the board / IC level, with the key role being the IC Chairman
Process	Strong beliefs	Strong investment beliefs commanding fund-wide support that align with goals and informs all Investment decision-making
	Risk budget framework	Frame the investment process by reference to a risk budget aligned to goals and incorporates an accurate view of alpha and beta
	Fit-for-purpose manager line-up	The effective use of external managers, governed by clear mandates, aligned to goals, selected on fit for purpose criteria

Global best-practice – exceptional attributes

- But global best-practice is based on additional factors which mark these funds out as exceptional
- The resources associated with fulfilling these points are considerably greater than normal.

Exceptional best-practice factors		
Coherence	Highly competent investment executive	The use of a highly investment competent investment function tasked with clearly specified responsibilities, and accountabilities to IC
People	High level Board competencies Supportive compensation	Selection to the Board and senior staff guided by: numeric skills, capacity for logical thinking, ability to think about risk and probability Effective compensation practices used to build bench strength and align actions to the mission, different strategies according to fund context
Process	Competitive positioning Real-time decision making Learning organisation	Frame the investment philosophy and process by reference to the institution's comparative advantages and disadvantages Utilize decision-making systems that function in real-time not calendar-time Work to a learning culture which deliberately encourages change and challenges the commonplace assumptions of the industry

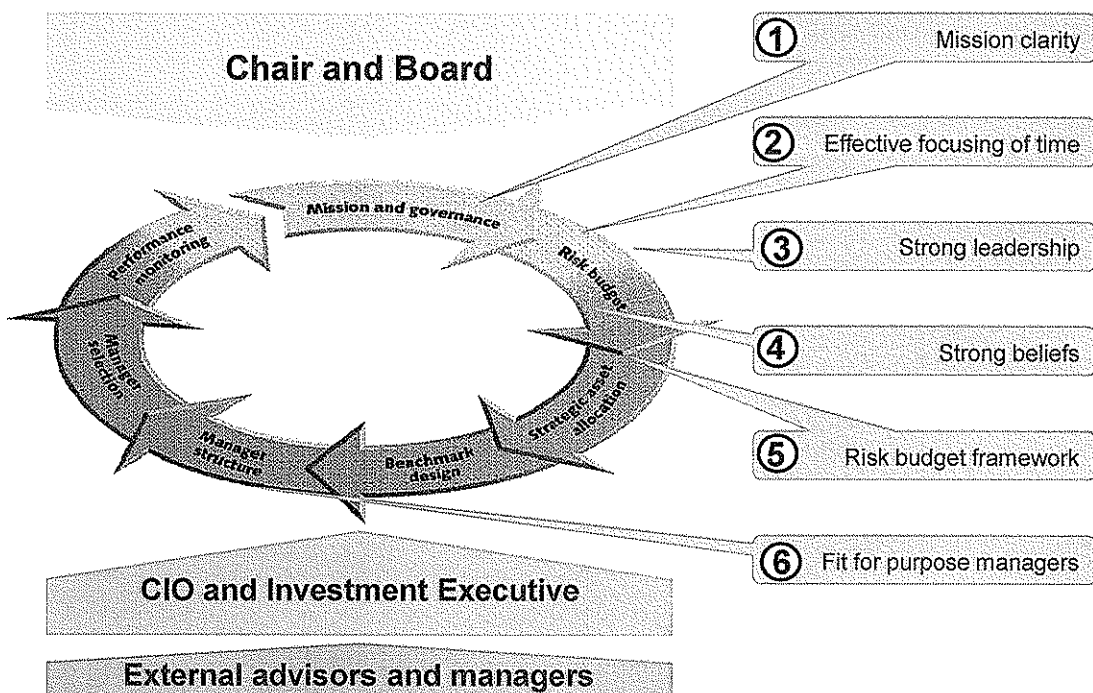
Hard things that research tells us about governance

Key research conclusions on governance taken from Clark and Urwin

1	Governance budget	Performance is linked to the size of governance budget employed, a combination of the time, expertise and collective effectiveness of the Board set-up
2	Global best practice	The methods and behaviour of global high performing funds can be captured in a list of global best practice (GBP) factors – around 'people', 'process' and 'coherence'
3	Mission clarity	Prominent among GBP factors is the importance of clarity of the mission, the commitment of stakeholders to the mission, the measurement of the outputs relative to the mission
4	Two tier structure	Also prominent among GBP factors is the two-tier structure with Board decision-making at a high level and an executive team delegated responsibilities in a complementary role
5	Process	GBP funds demonstrate a rigour and clarity with their investment process around beliefs, risk budget and real-time reviews of managers and strategic choices
6	Chair skills in mediating	Effective Boards have chairs that manage collective commitment and optimise a limited governance budget notwithstanding differences in competency, trust and reliance
7	Chair skills in framing risk	Effective Board chairs create a strong risk management framework and dialogue by moulding individual beliefs and pre-dispositions into collective belief systems
8	Delegations of Boards	Boards should delegate more effectively, either to internal teams, or to external organisations fulfilling CIO type roles
9	Intensification under stress	Funds operating in stressed and complex investment conditions need to be able to intensify their efforts to build a macro view of opportunities and threats to position strategy
10	Risk dashboards	Stressed and complex investment conditions require sophisticated quantitative disciplines with respect to risk overlaid with qualitative treatment of scenarios and wider risks

Governance gap analysis against global best practice

Core best practice attributes



Global best practice Investment Committees and Investment Executives

- As an adjunct to our global best practice governance research, Towers Watson has developed a model structure for a best practice Investment Committee, and for the desirable responsibilities of the following roles:
 - Investment Committee
 - Investment Committee Chairperson
 - Chief Investment Officer
- The best practice structure and sample responsibilities for each of these roles are described on the following pages.
- We recognise of course that there is no single best practice model, and that responsibilities can differ within different organisations.

The 'Global Best Practice' Investment Committee

- The table below illustrates some of the structural characteristics that are observed in best practice Investment Committees.

'Best Practice'		'Best Practice'	
Number	<ul style="list-style-type: none"> • ideally 4-5 	Governance reporting	<ul style="list-style-type: none"> • substantial disclosures • governance beliefs/principles
Board composition	<ul style="list-style-type: none"> • Chair is 'semi-exec' • Representation membership + Outsiders • CIO on Committee or in attendance 	Number of meetings/days	<ul style="list-style-type: none"> • 10-12 scheduled meetings • Off-sites
Board member tenure	<ul style="list-style-type: none"> • 3 year terms • no term limits • long tenures desirable • organisational continuity 	IC core agenda	<ul style="list-style-type: none"> • items covered by impact • beliefs statements • limited time on alpha • traffic light protocols for reporting/escalating
Control over new Board members	<ul style="list-style-type: none"> • investment competency • fit with team 	IC variable agenda	<ul style="list-style-type: none"> • Joint Ch/ CIO agreement • Education/ development
Committee member evaluation	<ul style="list-style-type: none"> • annual process • performance management 		
Committee member compensation	<ul style="list-style-type: none"> • full market rates • time element 		

The 'Global Best Practice' Investment Committee

- Below is the sample of responsibilities for best practice Investment Committees

	Responsible for	Notes on the role
Central leadership role	<p>Focusing the fund on appropriate mission, goals and vision; through its decisions /interactions help it to achieve its goals</p> <p>Development of investment beliefs that support the mission</p> <p>Development of high level investment policy appropriate to the mission with associated detailed KPI's</p> <p>Establish governance framework (responsibilities and accountabilities) and governance budget</p>	<p>'Mission' clarity; explicit investment goals</p> <p>Collective beliefs critical</p> <p>Performance management</p> <p>Use of both main Board and Committee structures</p>
Leading and providing oversight to management	<p>Developing an effective working relationship with Board and CIO, contributing to teamwork/ culture</p> <p>Providing oversight to management and ensuring the CIO is carrying out its roles effectively;</p> <p>Oversight in relation to the investment beliefs/ philosophy of the CIO and their complementary fit with the Board</p> <p>Review and sign-off key investment decisions: risk budget, asset allocation</p> <p>Review other investment decision-taking: manager line-up</p> <p>Review operational aspects; in particular risk management</p>	<p>Build cohesive organisation</p> <p>Product of board/ executive more than sum of parts</p> <p>Cohesion of belief structure and competitive edge</p> <p>High impact decisions</p> <p>Lower impact decisions</p> <p>Includes audit</p>
Leading externally	<p>Ensuring effective relationships with all major stakeholders</p> <p>Building and enhancing the fund's brand</p>	<p>Sponsor, also key suppliers</p> <p>'Brand' value proposition</p>

The 'Global Best Practice' Investment Committee Chairperson (ICC)

- Below is the sample responsibilities for best practice ICC.

	Responsible for	Notes on the role
Leading the Committee	<p>Leading the Investment Committee in the fund's mission, and through deciding its high level investment policy, help it to achieve its goals</p> <p>Organising the composition, business, efficiency and culture of the board</p> <p>Heads the Committee evaluation process</p>	<p>'Mission' clarity; explicit investment goals</p> <p>Information clarity and flow;</p> <p>Performance management</p>
Leading the Executive	<p>Building the investment beliefs of the Board and their complementary aspects to the CIO/ executive beliefs</p> <p>Developing effective working relationship with Board and CIO, and contributing to the leadership culture</p> <p>Ensuring the CIO and its team is carrying out their roles effectively; leading the appointment/ replacement process when necessary;</p>	<p>Cohesion of belief structure</p>
Leading externally	<p>Ensuring effective relationships are maintained with all major stakeholders</p> <p>Building and enhancing the fund's brand</p>	<p>Particularly sponsor, and beneficiaries, also key suppliers</p> <p>'Brand' acts to strengthen value proposition and draw in talent</p>

The 'Global Best Practice' Chief Investment Officer (CIO)

- Below are the sample responsibilities for best practice CIO.

	Responsible for	Notes on the role
Assisting the Investment Committee	Assisting the Investment Committee in their discussions and decisions, particularly with respect to investment policy and goals Articulating to the Investment Committee recommendations on investment strategy, getting their engagement, being accountable to them for results	CIO can be member of IC or in attendance
Setting strategy and leading the implementation	Developing and enhancing the investment philosophy of the fund, particularly its belief structure and risk budget Managing the manager line-up through design of external mandates and selection/ de-selection decisions and inter-actions Managing the allocations (cash flows, rebalancing, tactical positions) to asset classes/ strategies within the agreed investment strategy	The CIO belief structure will go deeper than the ICC's CIO takes responsibility in real-time for these decisions CIO takes responsibility in real-time for these decisions
Building the team	Selecting and organising the internal members of the executive team Establishing operational processes for all required investment actions and being accountable for operational performance	Executive team will vary in size
Working with the TMT	Developing effective working relationship with the ICC and contributing to the leadership culture Supporting the ICC in the enhancement of the fund's brand and its stakeholder relationships	ICC and CIO have critical working relationship

Dashboard monitoring

Dashboards - theory, research and practice

The dashboard concept is an approach which we recommend Investment Committee use to more effectively manage their meeting time and agenda.

- **Clark and Urwin** (2007, 2009) showed that governance budget is a variable that can be enhanced as well as how dashboards can be used to do that
- **Eckersley** (2005) defined corporate **dashboards**
- **Kaplan and Norton** (2002) produced the influential balanced score-card methods
- **Thaler and Sunstein** (2008) demonstrated that all decision-making incorporates distortions producing unhelpful actions and how 'decision architecture' could filter out these actions and streamline decisions

1. The dashboard as a tool to increase governance budget

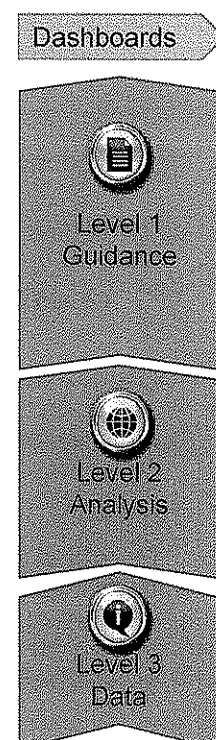
2. Dashboards have been developed to support business

3. Dashboards can be adapted to nudge faster better decisions

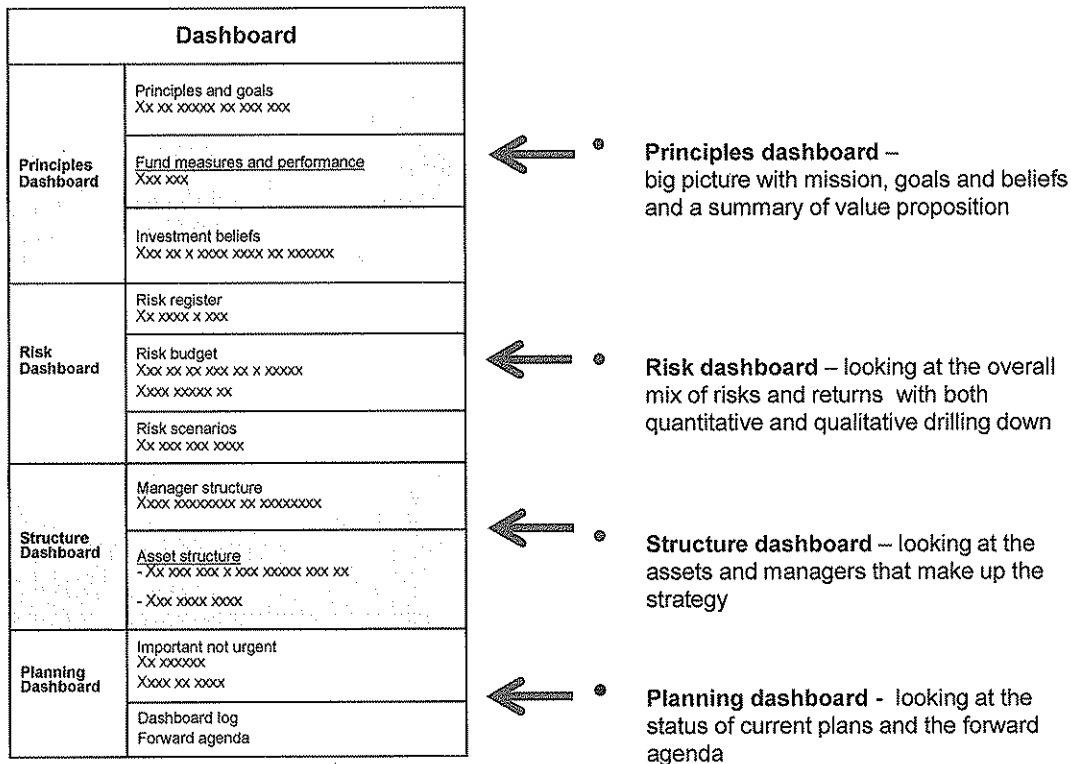
The dashboard concept

What is in the dashboard?

- Analysis and guidance needed for decisions, not just the data
 - Dashboard papers are divided into 3 section which we term 'levels' as they indicate the priority of importance
 - Level 1 refers the key paper for the meeting. The paper is designed to highlight and provide guidance on the decisions required for in the Investment Committee meeting.
 - Level 2 contains separate papers providing the core analysis and commentary to guidance suggested in Level 1. These reports can be organised under different headings as suggested in the following page.
 - Level 3 papers are further supporting material which we consider as supplementing the Level 1 and 2 papers, providing deeper and broader briefing
 - The hierarchy of these papers is an important design feature. Investment Committee members can spend time on important items bin Level 1, but drop down to Level 2 and on occasions to Level 3 to gain fuller understanding. The navigation tools help to make this form of covering material fast and efficient. These are summarised overleaf.






Structure of a dashboard



How dashboards improve monitoring

- We use a simple coloured tab rating to rank the importance of issues within each dashboard category:

 -  **Red octagon for Resolution:** this item requires immediate resolution, with a **decision**
 -  **Yellow triangle for Attention:** this item requires **attention**
 -  **Green square for Information,** this item is for information, and **no other action**
- Issues within the dashboard can then be easily prioritised based on their importance and incorporated into the Investment Committee's meeting agenda, systematising meetings and decisions. Therefore, dashboard facilitates better meetings, not just better reporting. Please see next page for an example.
- Electronic delivery of the dashboard can streamline meetings and reporting and enable Investment Committee members to navigate their way around many sources of information, based on their needs. All papers (Levels 1 to 3) can be linked in to the dashboard electronically through links, enabling Investment Committee members to access them using links.

How dashboards improve monitoring

- Example: mapping dashboards to meeting agenda

Dashboard		
Principles Dashboard	Principles and goals Xx xx xxxxx xx xxx xxx	
	Fund measures and performance Xxx xxx	
	Investment beliefs Xxx xx x xxx xxx xx xxxxx	
Risk Dashboard	Risk register Xx xxx x xxx	
	Risk budget Xxx xx xx xxx xx x xxxxx Xxxx xxxxx xx	
	Risk scenarios Xx xxx xxx xxx	
Structure Dashboard	Manager structure Xxxx xxxxxxx xx xxxxxxx	
	Asset structure - Xx xxx xxx x xxx xxxxx xxx xx - Xxx xxx xxx	
Planning Dashboard	Important not urgent Xx xxxxx Xxxx xx xxx	
	Dashboard log Forward agenda	

Agenda		
1	Asset structure For decision	Xx xxx xx xxx x xxx x x xxx xxx xxx x x xxx x xxx xxx 45 minute item
2	Risk budget For discussion	Xxxx xxx x xxx x x xxxxxx xxx x x xxx x xx 30 minute item
3	Manager structure For discussion	Xxx xxx x x xxx xxx x xxx x xxx xxx x x xxx x xxx x xxx xxx x x xxx xxx 30 minute item
4	important not urgent For discussion	Xxxxx xxx x xxx x x xxxxx x xxx xxxx x x xxx x x xx xxx x xxx xxx xxx
5	Dashboard For noting	-Xxxxxxxxxxxx xx xxxxx - xxxxxx 15 minute item