

Presentation to CIPFA Annual Conference

12 November
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Signatory of the UN Principles of
Responsible Investment



Agenda

- Governance problems exist in many pension funds
- So what?
- Can we solve these problems?
- Some evidence
- Project

Do you agree?

- It is good to take time to arrive at an investment decision
- Investment decisions are a Pension Committee responsibility and hence need to be taken at Pension Committee level
- It is crucial to keep things simple and understandable
- Our advisors ensure that the investment managers offer value for money

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Common governance problems

- Translation from strategy to investment portfolio
- Poor / slow decision making
- Lack of transparency
- Information asymmetry
- Principal-agent issues (conflicts of interest)
- Wood <-> trees

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So what?

- Increased scrutiny



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So what?

- Increased scrutiny
- Headline risk

Pensions
expert

**Study: poor alts benchmarking hides
£1.1bn of underperformance**

FINANCIAL TIMES

**Britain needs local authority pension
revolution**

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So what?

- Increased scrutiny
- Headline risk
- Professional Liability?
- Career risk?

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Can we solve these problems?

- Consolidation will help, but..
- Expertise is better, so..
- Join forces, learn from good examples
- Where necessary, get extra resources

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Some evidence

UK fund (4,000 employers, 150,000 members, £5bn assets)

- Cost-benefit analysis to justify pension fund's service to employers
- Better split between governing and managing fiduciaries
- Quicker, better decision making

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Different employer segments

We identified four different segments of employers:

| Segmentation of employers | High complexity | Low complexity |
|---------------------------|-----------------|----------------|
| Small (GBP 100m) | A | B |
| Large (GBP 2000m) | C | D |

- A high level of complexity implies that employers seek a high level of diversification, active management and bespoke (dynamic) risk management
- A low level of complexity implies that employers seek a low level of diversification, passive management and simple (static) risk management

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Governance alternatives

We have looked at three alternatives for the organisation of the investment function:

1. Traditional model (investment consultant and some internal support)
2. Bespoke internal delegated CIO
3. Bespoke outsourced delegated CIO

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The benefits of bespoke investment governance

Conventional wisdom

- Clear governance and accountability
- Higher organisational continuity and less key men risk
- Access to more competent people
- Buying power on underlying manager costs
- Access to scarce investment opportunities and additional sources of return
- Higher diversification and access to innovative solutions on risk management, resulting in less downside in stress scenarios
- Efficient, fast execution (rebalancing)
- No conflicts and full alignment of interest

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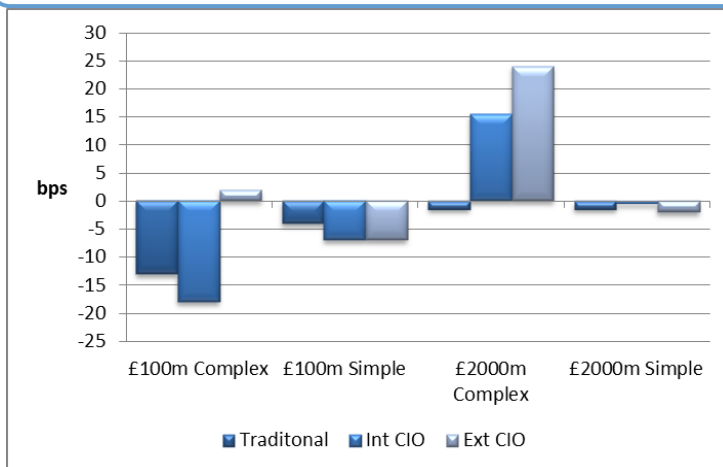
Qualitative assessment of governance cost & benefit

| Relative ranking of benefits - investment governance | Traditional model | Bespoke internal delegated CIO | Bespoke outsourced delegated CIO |
|--|-------------------|--------------------------------|----------------------------------|
| Clear governance and accountability Higher organisational continuity and less key men risk Access to more competent people | Low | Medium | High |
| Economies of scale and buying power on underlying manager costs | Low | High | High |
| Access to scarce investment opportunities and additional sources of return (expected alpha) | Low | High | High |
| Higher diversification and access to innovative solutions on risk management resulting in less downside in stress scenarios | Low | High | High |
| Efficient execution (rebalancing) and speed of movement | Low | Medium | High |
| Full alignment of interest | High | High | Medium |
| Relative ranking of costs investment governance | | | |
| Costs | Low | Medium | High |

Sources: International Centre for Pension Management, Toronto; Avida International

Organisational performance and governance

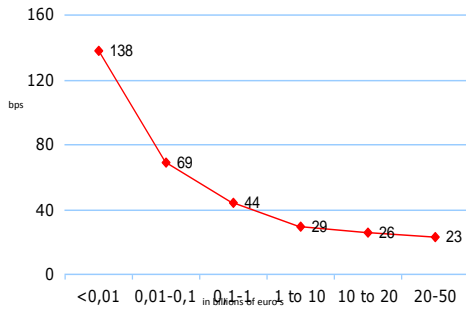
Quantitative assessment (benefit minus cost)



N.B. costs and benefits are based on a sample of 25 pension funds and international research. Main benefits consist of buying power, access to sources of return, limited downside risks and efficient implementation. Numbers are conservative but give a sense of direction.

The impact of scale

Total cost of investment management services expressed in basis points¹



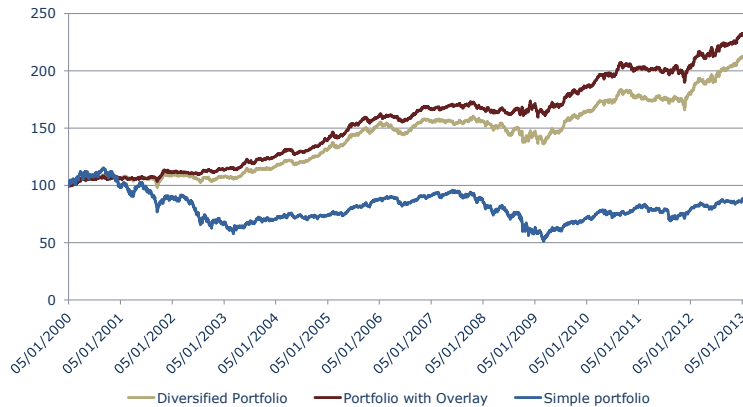
- Smaller pension funds often have diseconomies of scale, because fixed costs are spread over limited assets
- These results are consistent with research from CEM Benchmarking

Source: Bikker & De Dreu, Pension fund efficiency, the impact of scale, governance and plan design; 2009

¹ Including the organisational costs. Comparing investment costs among peers is often difficult due to the incomparability of investment styles (internal v external, active v passive) and the lack of completeness in publications.



Sound Investment Governance as an enabler of higher performance



Summary

- Governance is about transparency, and understanding and aligning underlying interests
- Sound investment governance enables better results. Some scale is important too
- Inversely, high complexity combined with bad governance is a recipe for disaster
- Fit the right governance solution – there is no one size fits all

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Project

- Case study of 4 local authorities to:
 - Discover best practices (what works well)
 - Learn from each other
 - Set example for others
- Volunteers, who are sufficiently advanced to:
 - Understand the importance of best practices
 - Be willing to learn and share
 - Be prepared to spend a little time and effort

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Thank you!

BAD GOVERNANCE



GOOD GOVERNANCE

