

# Managing the managers

Finding the right fund manager with the right level of expertise is essential for pension fund trustees. Neil Thomas of bfinance considers the selection process.

Largely owing to their superior level of financial knowledge, treasurers and financial directors who sit as trustees of pension funds are usually relied on by the other trustees to take a leading role. In many cases, trustees will employ an investment consultant to take on most of the work but they will still be heavily involved in the review and selection of fund managers.

The selection of a fund manager is the most important tasks for any pension trustee. Good investment performance can drastically enhance the fund's value, while consistent under-performance can lead to major additional funding needs for the company. In addition to the obvious performance issues, there are a number of other important factors that must be considered in the selection process.

In an environment where legislation affecting trustees' responsibilities is changing fast, it is imperative to find a manager with enough experience to keep abreast of these changes and provide up-to-date advice. Fund managers' client service and administration capabilities also have a big impact on their clients, but are often undervalued in the selec-

tion process. Other important factors to bear in mind include: who carried out the performance measurement; how the numbers were calculated; and whether they comply with industry standards. One of the most commonly used standards is the Global Investment Performance Standards monitored by the Association for Investment Management & Research and the Global Investment Performance Standards Committee.

When comparing the performance track records of fund managers the aim is to select the manager that will produce the best performance in the future. This may seem obvious but it is one of the most common mistakes and far too much emphasis is placed on past results.

The cliché 'past performance is not necessarily a guide to the future' is almost an understatement. It is accepted within the industry that a period of sustained outperformance will generally lead to a short period of underperformance. The performance of fund managers often seems to be cyclical and can probably be linked to the investment style and philosophy of the manager and the position of markets within economic

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tion process. Good client service and administration can help trustees avoid problems such as breaches of the management agreement and socially responsible investment policy, poor or inaccurate investment reporting and potential difficulties in producing timely accounts and returns.

### Selection process

Despite the beneficial impact the right choice of fund manager can have on the performance of pension funds and the legal responsibilities of trustees to review managers regularly, pension trustees are widely considered to be reluctant to ask their incumbent managers to re-pitch for their business. Building long-term relationships with fund managers can add considerable value in the form of trust and understanding. This should be taken into account by pension fund trustees when reviewing their fund managers, but should not prevent them from inviting existing fund managers to re-pitch against competitors on a regular basis.

When drawing up a shortlist the examination of the performance track record of a potential manager will always play a key part in any evaluation. But looking at performance numbers in isolation can be extremely misleading. Other factors need to be considered to gain a full picture, most notably the amount of funds under management in monetary terms and the number of funds for each asset class. For example, you may find that a manager with an outstanding performance in Japanese equities has only one small specialist unit trust under management, rather than a range of portfolios with a

cycles. Apart from the risk of selecting a manager at its peak, an over emphasis on past performance disqualifies managers who have not had such a good run but may be poised for a period of strong future performance.

As well as looking at past results to get the best chance of selecting a fund manager that will produce strong performance, gaining a reasonable understanding of the manager's investment philosophy and processes at the initial stage of screening candidates is essential.

Trustees will need to ask a number of qualitative questions in this area. They must ask the fund manager to explain the general investment philosophy of the house. For example, it is no good choosing a growth specialist if the pension fund is looking to generate a very high level of income. Additionally, trustees should also gain a good understanding of the fund manager's investment process. Fund managers are used to being asked this question and will be happy to talk about how they run their portfolios. Most managers use similar general processes but asking this question will highlight how they differ and which ones would best suit your needs. It is also important to ask questions about investment risk and to ensure that there are adequate procedures in place to monitor and control risk effectively.

After performance, the next most important consideration is the fund manager's experience. The recent Trustee Bill has meant there will be significant changes to the responsibilities of trustees and the way portfolios are managed – particularly the 'appropriate safeguards and duties of care'. These place

extensive responsibilities on a charity's trustees. Trustees' must decide how best to use these new powers in the interest of their charity because they are now obliged to review the investments of the charity regularly and to review the relationship with any nominated asset manager.

It is essential to pick an experienced manager who will cope well with the changes and provide solid help and advice. A good initial questionnaire will ask about the quantity of funds under management, number and type of clients.

How much individual attention and the level of service clients receive will vary significantly from manager to manager. Some are prepared to manage very small mandates on a segregated, directly invested basis, whereas others will offer only pooled vehicles for their smaller clients. It is essential to get an idea of how much individual attention managers are prepared, or able, to provide and how much they will value you as a client, as well as finding out about the team that will be managing the account and how many other clients they will be looking after.

## The level of service clients receive will vary significantly from manager to manager

There is a trade-off between the attention that will be given by the fund manager and other factors such as the size and resources of the manager. For example, a smaller manager may not have the same number of analysts following stocks or be able to invest as much money in internal IT systems, however, the quality of service provided may be superior just because they value their smaller clients more.

Having weighed up the aforementioned considerations, it is unlikely that trustees will need to separate competing fund managers by price. However, when fund managers appear to have different strengths and weaknesses in different areas of the selection criteria, price will clearly play an important role in the decision-making process.

Furthermore, trustees have a responsibility to ensure that they only pay for the fund manager the company can afford. Therefore, they should question fund managers closely on fee structures and invoicing periods. Typically, management

charges are invoiced quarterly as a percentage of fund value. Pricing scales will vary from manager to manager but are always negotiable.

As in all negotiations with financial institutions, the outcome will inevitably depend on the relative bargaining power of the parties involved. Because there is a widespread move towards performance-linked fees from standard fee scales, trustees should ensure that they fully understand the implications of this change.

### **Post-appointment monitoring of performance**

With the introduction of the Trustee Bill, trustees are now obliged to go to the market and compare the performance, fees and level of service on offer from a host of providers with those of their incumbent manager and ascertain which is most tailored to their investment needs.

The nature, size and objectives of the fund should be taken into account when trustees review their investment requirements. For example, the effort spent in monitoring the perfor-

mance of a discretionary investment manager should be proportionate to the size and complexity of the investment portfolio.

### **Importance of regular reviews**

Pension fund trustees can successfully review and select fund managers without incurring the extra cost of employing an investment consultant. By asking their existing managers to re-pitch against competitors, as part of their investment review process, and by enhancing the scope of this review trustees can feel confident that the organisation managing their funds is providing the very best service for their pension fund. ■

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## Correction - FX Options

In the March edition of *The Treasurer*, the example given in the 'transacting options' section of Andrew Moorfield's Treasury Essentials article *Time to widen your options* was incorrect. In the seventh paragraph, please read as follows:

"This means the option will cost \$1,500. The effect therefore of buying the option is to fix an exchange rate of no worse than \$1.5225, this being the proceeds of \$100,000 at the forward rate of \$1.5 plus the price of the option, \$1,500 which equates to 225 basis points. For a UK buyer the option premium would normally be charged at the deal date in sterling converted from the dollar amount at the spot rate."

## Treasury Essentials.....

**T**reasury Essentials is a series of articles designed to provide finance professionals and students of treasury with a practical framework about the fundamentals of treasury and treasury management. All these articles are available on the Association's website: [www.treasurers.org](http://www.treasurers.org).