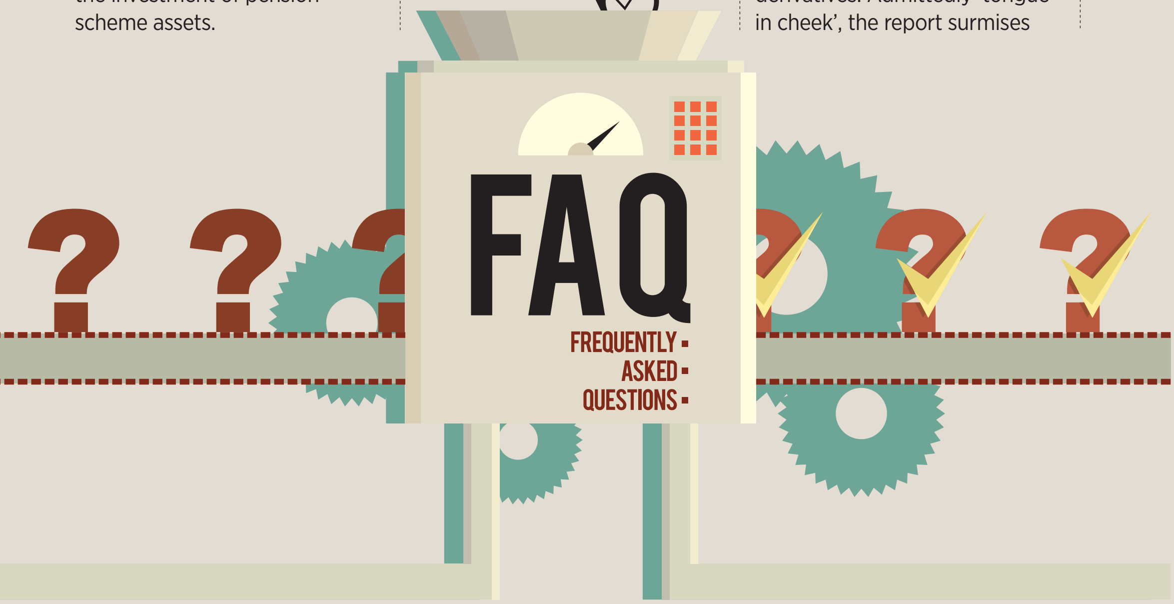
ASK THE RIGHT QUESTIONS

WHAT'S THE SECRET TO QUIZZING PENSION SCHEME TRUSTEES? JAMES MEENAN SHARES HIS TIPS

Let me start by asking a few questions:

- How often do trustees attend investment meetings not having been able to read the information provided and prepare their response?
- How many simply do not have the time to prepare a constructive dialogue with either investment consultant or manager?
- How would trustees react if members felt they were not properly prepared to discuss the investment of vast sums of money on their behalf?

Heads won't roll, but they very often nod when these questions are read by those involved in the investment of pension scheme assets.



Making tea or investments

In 2012, a survey of 300 defined benefit pension funds was carried out on behalf of Russell Investments to ascertain the actual time trustees and their investment committees spend on investment issues. Including both trustee and investment committee time, the average figure was 15.6 hours per annum.

On closer analysis, trustees in the largest schemes spent on average 25.7 hours per annum and the smallest 7.5 hours. Larger or more complex schemes typically ran active strategies with multiple specialist managers, often using alternatives and derivatives. Admittedly 'tongue in cheek', the report surmises that many can spend more time in any year making tea than on investment issues.

Time

Are you, perhaps, one of the many who simply cannot give the time you would like to pension investments? Do existing structures make it easy to discharge your obligations and responsibilities? Are you ever concerned that your processes might not demonstrate as much prudence and diligence as you would prefer?

If the answer to any of these questions is 'yes', a useful starting point might be to accept and recognise this reality. Given that many full-time professionals struggle to navigate the global markets successfully, the challenges are exponentially greater for most trustees with primary responsibilities elsewhere. Simply put, it is not always straightforward to understand investment information.

Ironically, a mindset predicated on this reality can, ultimately, contribute more to the investment process and, hopefully, the investment outcome. As time is, very probably, in short supply, are there ways of making the time allocated more effective by getting to the core information quicker?

Much of the content of investment reports is determined by compliance and regulatory requirements. While often confusing, this won't change – not quickly at any rate. That does not mean that additional information cannot be provided to help clarify the subsequent detail, however.

For example, how about asking for a customised supplement at the start of your report, which gives information in a sequence and layout determined by you? There are some questions that you might ask that will enable you to access some core information and quickly bring you into the investment dialogue.

Reviews and outlooks

Reviews and outlooks in reports can be general, and not especially relevant. Alternatively, submitting questions in advance of an investment meeting can bring greater focus and control over the meeting agenda.

Instead of a review commentary, you might have the following questions answered in this supplement:

- Which equity markets have performed best?
- Which fixed income markets have performed best?
- Which alternative markets have performed best?
- Which real estate markets have performed best?
- Are there any other notable performers, for example, gold, commodities, etc?

Pretty quickly you will be able to put your own portfolio performance in context, not just in relation to any agreed benchmark, but, also, to opportunities elsewhere during the period of the report.

No one is expecting managers to flit from one market to the next on a quarterly basis, but if superior returns from viable markets are being consistently missed without explanation, it will certainly provide the basis for some informed discussion.

And instead of an outlook commentary, you might have the following questions answered in the supplement:

- Where are the best opportunities for capital growth?
- Where are the best opportunities for income?
- Where are the best opportunities for capital preservation?
- Where are the best opportunities for diversification of returns?
- Are there any other notable opportunities?

Again, pretty quickly, you will have an idea of what your advisers' and managers' recommendations are. No one expects that the entire portfolio will concentrate exclusively on these areas. But you will be able to monitor changes in the portfolio to reflect these recommendations. Information in this format is likely to be more relevant to your portfolio performance and objectives rather than broadly based comment.

Conclusion

It is impractical to include an exhaustive list of questions for this article, and particularly for the hedge funds (see Investment objectives box, above). There are many other basic questions that could, and should, be asked. As is apparent, there is no reference to liquidity, leverage, currency, security lending, selection procedures, among many other features of investment portfolios. But, hopefully, some of the suggested questions will efficiently bring you to a space where you can have a more knowledgeable, confident and constructive dialogue with investment professionals.

That said, the optimal approach is to take time to go through the investment reports and draw up your own lists of questions. If others involved can do the same and a list of questions is submitted in advance, then you can start to control the meeting agenda, and give it additional focus. The suggestions made here assume you might not have that time.

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INVESTMENT OBJECTIVES

It is important to understand the investment objectives, not just for the overall portfolio, but also for the different categories of investments – asset classes and subsets within asset classes. Do the different investment objectives complement the schemes' objectives? For both segregated and fund portfolios, what is the rationale for the asset allocation, and the allocation to the different subsets within the asset classes? In particular, do the different allocations complement the investment strategy recommendations that you have just clarified?

Risk
What is the risk for the portfolio? How is it measured? How is it explained and are the explanations understood by all the trustees? Are there exposure limits among managers and funds? How are concentrations monitored? Are there underlying concentrations accumulating that might not be readily visible? For example, in 2008, there was an underlying exposure to real estate across different asset classes, despite many believing they were properly diversified.

Benchmarks
What is the rationale behind the selection of the benchmark for the overall portfolio? Might the investment strategy be inhibited by the benchmark selection? Should other benchmarks be considered? What has been agreed as the review process for the benchmark?

Diversification
Have your investments suffered from excessive volatility? Is there adequate diversification of actual return characteristics, as opposed to assets? Have you discussed other strategies with your advisers or managers that might help to reduce volatility? Are there non-market-correlated investments under consideration?

Hedge funds
The heterogeneous nature of the hedge fund space means it differs from other asset classes, and many more questions need to be asked – slowly. It is not just important to understand the investment objective of a fund, but also different hedge fund sectors, strategies and portfolio designs. Why exactly are hedge funds being included? Which precise advantages are the inclusion of hedge funds designed to bring? What is the rationale for the hedge fund and the allocation to it? Are the rationale and approach genuinely different from investments in the other asset classes with similar objectives? How will they be accomplished? What competitive edge does the manager have? In particular for hedge funds, what are the costs? These questions are only the tip of the iceberg, but should help to facilitate a constructive initial discussion.

Performance
What is the historical performance of the managers or the funds? Are there performance figures available for the subsets within the asset classes? Are there volatility or standard deviation figures available for comparison with other investment choices and managers? Are there historical peak-to-trough and recovery figures available? How do these figures compare with relevant benchmarks? (These questions are even more acute for hedge funds.)

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