

Setting Briefs For Investment Managers

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History of setting briefs

Fully discretionary

Expect to beat inflation over “long-term”

Little measure of skill of manager

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History of setting briefs

“How is my manager doing vs. others?”

Beat average of peer group objectives

**Peer group became asset allocation
benchmark**

**Index or peer group within each asset
class**

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Problems arose

Asset allocation decisions became relative

No longer “fully discretionary”

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Today - Specialist Briefs

Trustees set strategy

Asset allocation decision by trustees

Different manager for each asset class

Index benchmark for each manager

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Specialist briefs - problems

Index “hugged” by managers

Business risk to managers

Index seen as construction benchmark

Intention: performance benchmark

“Risk” seen as underperformance of index

Below index seen as bad as absolute loss

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Specialist briefs - problems

Stock concentration – 12% in Vodafone

From a manager who didn't like it

Asset allocation implies stock weighting

BP (3%) vs Exxon (0.2%)

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Present and Future

“You get what you measure”

So measure the right things:

Objectives of fund manager should...

...line-up with objectives of trustees

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Investment Objectives of Trustees

Long-term:

Meet pension payments

Short-term:

Increase funding level

Low risk of reduction in funding

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Present and Future

Liability matching

Liability-plus

Unconstrained – specialist

Unconstrained – “new discretionary balanced”

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Liability Driven Investment

Liability matching

Provide liability information to manager

Asked to determine asset benchmark...

...that is near-match to liability cash-flows

Manager tracks that benchmark

Benchmark adjusted as liabilities accrue

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Current Membership Profile

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Time 0

Number of members

Age

Spouse Child

Participant

Retiree

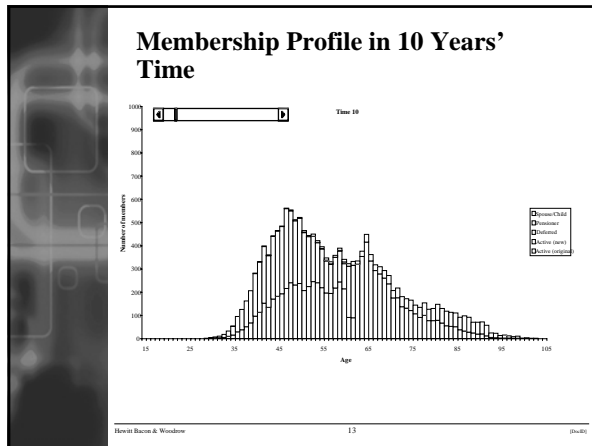
Active (new)

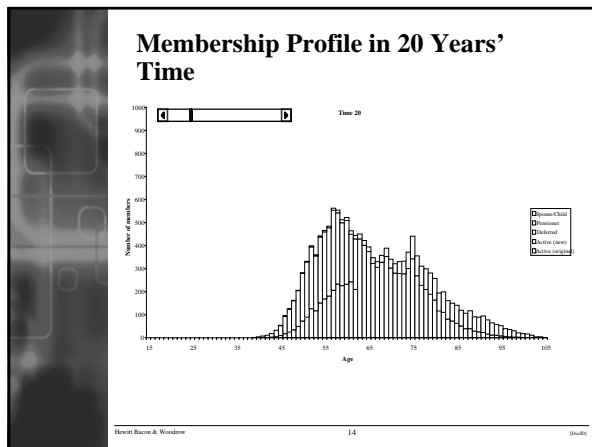
Active (existing)

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Liability Driven Investment Liability plus

Benchmark is as before


Objective is to outperform benchmark

Active positions from any asset class

Hedge fund overlay(?)

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Potential Problems

Long-term view from trustees...

...and managers

Does not mean trustees “buy and hold”

Performance is not the only trigger to replace a manager

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