

Institutional Fund Forum International

Trustees, governance and manager selection after the crisis

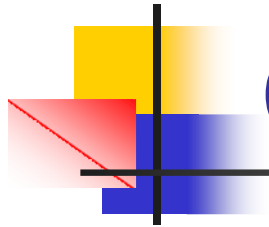
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Dr. Ros Altmann



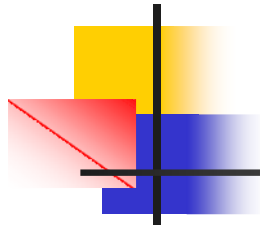
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Overview

- Problems for trustees
- Governance
- Understanding risks
- Manager selection and monitoring
- Future



Problems for trustees

- Deficits and pension shortfalls
- Lost faith in traditional approach
- Looking for new ways forward
- Complexity, confusion, fear
- Lost faith in alternatives too!
 - Scandals, hedge funds, misunderstandings
- Problem for both defined benefit and defined contribution



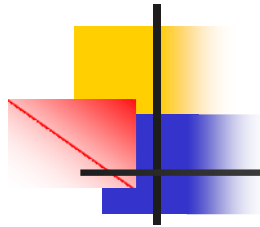
Causes

- Misconceptions about risk
 - Over-reliance on equity risk premium
- Insufficient downside protection – insurance
 - ‘expected returns’ not same as ‘achieved returns’
- Pension investing is far more complex than has been recognised – and less reliable
- Diversification?
- Professional approach?
- Governance budget for investment?



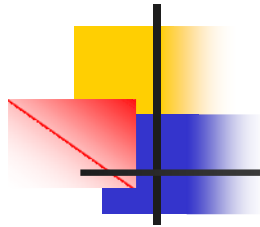
Governance

- Stronger governance is critical – huge complexity
- Need more complete picture
- Professionalisation of processes and advice
- Documentation and discussion
- Prioritise greater risk control



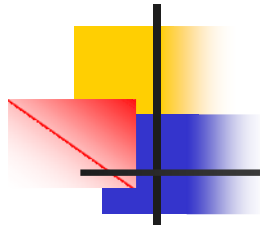
Trustees and investment risks

- Understanding risks
- Not just standard deviation of return or index underperformance
- Protect against rising liabilities and falling assets – derivatives?
 - Counterparty risk
- Adding value from active management
 - Manager risk
- Advisers to help select – and monitor – managers
 - Adviser risk



Understand, manage, control risk

- Must take some risk to overcome deficit or weak sponsor
- Must also hedge some risk to protect funding position
- Diversification and downside protection – reduce risk as efficiently as possible
- Balancing risks and 'expected' returns
- How much investment risk to take and what type of risk?
- Cannot eliminate risk unless full buyout



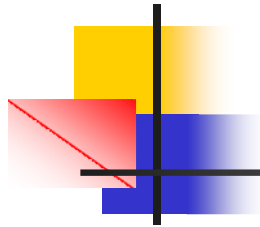
Manager selection and monitoring

- Diversification of asset classes and managers
 - Alternatives have not failed
- Establish a manager selection process – use advisers
- Performance issues – absolute vs. relative returns
- Increasing demand for alpha
- Separate alpha and beta
- Performance fees – for advisers and managers



Alternative asset allocation approach

- Equities only one source of risk premium for high returns
 - Alternatives e.g. illiquidity, currency, specialists
- Diversification improves portfolio efficiency
- Capture passive beta
- Search for equity alpha – long only or long short?
- Capture beta return from inefficient non-equity markets
- Capture alpha from talented non-equity managers



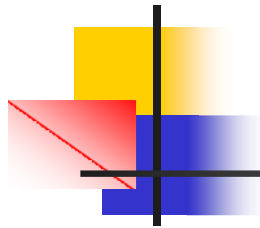
Defined contribution schemes

- Default options
- Downside protection
- Investment advice and risk
- Fund manager selection
- Diversification or confusion



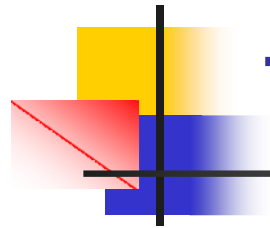
Next steps

- Improve governance and professionalism – best advice
- Understand, manage, control risks
- Self-evaluation
- Clear documentation
- Manager selection, monitoring and performance issues
- Economies of scale – schemes merging?



Conclusion

- Traditional investment approaches had unrecognised risks
- Complex - no one right solution – it's not easy!
- Protection of downside risk vs. liabilities, keep upside
- Manager selection and monitoring
- Combination of alpha and beta
- Huge challenges will make life more interesting!



Thank you for listening

Questions...

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