Avida International

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Trustee Board and Investment Committee decision-making – what reporting support do you really need to be effective?

Investment decision making is difficult for even the most specialist investment managers. And they have clear and unambiguous benchmarks to measure the success of their decision making against. They also have frequent, accurate and to the point information on how well they are doing versus their benchmarks.

Investment decision making for pension fund Trustee Boards is even harder. Often their benchmarks are a combination of various - even conflicting - objectives. Closing the funding gap whilst keeping downside risk limited is one. Maximising sponsor contributions whilst keeping the covenant strong is another.

To make matters worse, reporting is often incomplete, inconsistent and sometimes even inaccurate. There are various reasons for this: pension funds often get their reporting from external service suppliers, such as the actuary, custodian, investment adviser or fiduciary manager. These suppliers report on the specific service they provide, leaving the pension fund to put the pieces of the puzzle together. But the suppliers may use different assumptions, different calculations and different source data. This can make putting the puzzle together an almost impossible task. The result is that pension funds spend more time on reconciling data than on analysing the information.

Some service providers, like fiduciary managers, offer to put the pieces of the puzzle together for the pension fund. This is helpful, but not a solution given the need to have information independently verified, particularly data coming from providers who have a commercial interest in presenting their data positively.

So how is a pension fund Board to make investment decisions in these circumstances? This was the topic of a roundtable discussion organised by Avida International earlier this month, attended by 13 representatives of UK pension funds, together worth about £250bn in pension assets, or almost 20% of all pension assets in the UK.

All participants agreed on the need to take reporting back to the pension fund's objectives. If the pension fund's Board has delegated investment decision making within certain restrictions (whether risk related or otherwise) to an Investment Committee (IC), this means different reports should go to the IC and to the Board, because the objectives of the IC and Board will differ. If the pension fund has an internal CIO to whom the IC has delegated some decision making, it again calls for dedicated reporting for the CIO. Whilst this puts a burden on the infrastructure needed to produce all these reports, it is seen as essential to report back to each governance layer's objectives.

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The challenge is to restrict reporting to what is essential for Board and Committees, and this is where most pension funds have work to do. The more detailed the reporting, the more likely it is that discussion is going to focus on the detail rather than the big picture. This is not a good use of the Board's time, whose focus should be on the big strategic issues rather than on detail.

Good reporting is also about finding the right balance between backward-looking and forward-looking information.

Backward-looking information is important in order to learn how previous decisions have impacted the financials; this includes the, often overlooked, need to assess what the impact of *not* taking decisions has been. Backward-looking information also helps with assessing how well your assumptions have worked out (eg. "did interest rates rise as much as we expected them to do?"). Board members are often successful business people and they can have a tendency to become overconfident about their ability to predict where markets are going. Good reporting includes a comparison of predicted market moves with reality. This can result in healthy humility.

Providing good forward-looking information is another area where most pension funds have work to do. Assessing the impact of forward-looking scenarios is a very helpful method to narrow down the decision making to which actions are acceptable and which are not. Whilst choosing scenarios will bring its own challenges, it is certainly a lot better to think about what might happen than to just expect that your (or the investment consultants') assumptions will come true.

If that all sounds like hard work, bear in mind that the sponsor often has their own reporting demands on the pension fund and that regulatory reporting requirements will only increase in coming years. Pension fund investment decision making truly does require hard work.