



Professionalism and Governance

Governance Assignment 4 Notes

(Part 3–Selection of Investment Providers)

Recommended Time: 2 hours)

1. Case Study:

You are the pension consultant to the Trustees of the High Flying Cloud Pension Scheme. At the recent Trustees' meeting concern was expressed regarding the fund performance of the funds managed by ABC Passive Investment Management Limited. You have been asked to write a report for the Trustees describing performance measurement and outlining why the objectives set for ABC Passive Investment Limited are not the same as those of XYZ Active Stars Investment Limited. You have also been asked to explain the criteria that the Trustees might consider should they wish to select an alternative or additional fund manager.

Marks would be given for outlining of the structure of the report, re-stating the objectives.

Performance Measurement

- one of the main methods of monitoring an investment manager.
- establish as accurately as possible the rate of return earned on the assets of the portfolio.
- comparison to the benchmark set by the trustees for the investment manager
- nature of the mandate passive or active
- passive manager such as ABC Passive Investment Limited is employed to track an index while an active manager such as XYZ Active Stars Investment Limited is usually employed to beat an index
- performance attribution – impact of asset allocation and stock selection.

Performance Targets

- Relative Return: including peer group benchmarks and % above a specified index
- Absolute Return: positive return target, all market conditions, cash rate usually measured by LIBOR
- Performance targets linked to liabilities: liability driven investment. Strategy can be a core matched portfolio and a return seeking component



Factors to consider when selecting an investment manager

- Shaped by strategy but there are general factors to take into account.
- Changing investment manager is expensive – fees and transition costs
- The Business
 - Current and future strength.
 - Relationship with any parent company
 - Turnover of clients
- Investment team and structure
 - Quality and experience
 - Staff turnover
 - Incentives
- Investment process
 - Individual manager selection or house style
 - Who drives investment decisions and is it appropriate
- Management of Risk
 - Risk Controls, systems and management structures
- Systems
 - Quality and commitment to updates
- Performance
 - Past performance no guide to future performance
 - People or process – any changes could performance be repeated
- Client service
 - Timely Reporting
 - Availability to attend meeting
- Fees
 - Relative fees may be relevant for passive managers otherwise should be within range of accepted industry standards
 - Good performance should override fee considerations
 - If linked to performance should encourage and reward outperformance but not encourage risky investment. Underperformance penalties should not be too penal.
- Transition management process
 - Awareness of costs incurred in switching and effective transition management to minimise costs
- Counterparty relationships
 - Wide range of counterparties may provide better terms

(The relevant sections of the Study Manual are Part 3, Chapters 1, 2 and 3.)

60 marks