Where Trustees Fail

Without question, one of the most valuable starting points for most trustees is to listen to other Trustees. Where have they failed in the past, what could they have done better? In an American study on pension fund excellence, senior pension executives were asked to identify the leading factors that lead to poor results in their funds.[1] Their responses may come as a surprise:

Barriers to Excellence in Pension Fund Management

Rank	Barrier	Cited (%)
1	poor process in terms of decision making, investment policy setting and communication	98%
2	Inadequate resources and guidance	48%
3	lack of clear mission or focus	43%
4	Trustees too conservative	35%
4	Trustees had insufficient skills	35%
6	Inadequate technology to assess and monitor	13%
7	Conflicting values and investment beliefs	8%
7	Difficult markets	8%
9	Lack of innovation	5%
9	Failure of fund managers and suppliers	5%

The most notable point that is being made here is that it is not fund manager performance that is cited as the primary source of failure, but rather the poor process of decision making and policy setting.

Where Trustees Fail

Q. What's the worst (and first) mistake that trustees typically make?

A. Embarking on a search for asset managers before:

Understanding the dynamics of decision-making in groups and establishing the right governance framework for managing the process.

Identifying an investment policy that is appropriate to the funds funding requirements or performance expectation

Identifying what long-term strategic asset mix best services those funding requirements

Establishing the risk parameters for the fund i.e. the degree to which the fund is permitted to deviate away from its minimum funding requirement[2]

"Trustees "own" the central responsibility for formulating and assuring implementation of long-term investment policy. This responsibility cannot be delegated to investment managers. Fortunately, this trustee responsibility can be fulfilled without extensive experience in securities analysis or portfolio management[3].

But to fulfil these responsibilities, trustees need to have:

1. **A genuine interest in understanding of the needs of the members.**
2. **A basic understanding of why human nature often leads to the wrong investment decisions.**
3. **The disciplines to develop and follow the basic policies that will, over time, succeed in achieving a realistic investment objective.**

Chapter 1 Getting it straight from the start

Not failing, then, is highly dependent on developing a game plan that can map out a road for trustees to follow.

1.1. Trustee Decision Making – A Game Plan

Step 1.

Determine the optimal composition of the board for effective decision-making.

Step 2

Determine how the board will make decisions. Establish a governance budget and policy statement that identifies who makes what decision, what skills does the board possess and what skills will have to be sourced, how often which decisions need to be revisited, and under what conditions would changes be allowed?

Step 3

Determine Fund's Investment Goals and Mission Statement (What are the fund's objectives? What is its funding policy? What are its funding targets? Who are the stakeholders and what do they require from the fund? Who is affected by investment return? How does the board define the creation of investment value?).

Step 4

Determine tolerance for risk. What is the maximum deviation from these funding objectives that the fund or its members can endure in the quest for greater long-term return.

"Most trustees' tenure period is around 3 years. Most pension funds should be operating with a time-frame of around 30 years. Trustees most often make the wrong decisions because they are thinking only of the protection of those assets over the 3 years of their tenure and do not consider what the impact of those decisions would be over thirty years."[4]

"Most governing boards operate on a part-time basis in an environment where consensus comes first."[5].

"Á Note to Trustees:
Rid yourself of this desire to win. It's like going on a long, cross-country drive. If you stay in your lane you have a higher probability of getting there without being run off the road." [6]

Step 5.

Determine how to optimally allocate to different strategies and different asset classes to achieve funding requirement in time-frame stipulated.

Step 6.

Establish an investment decision tree that reflects boards beliefs about investing at each step in the process: active vs. passive, fixed asset allocation vs. variable, specialist vs. generalist, etc.

Decisions should be based on:

- probability each strategy has of meeting fund's objective over specified time-frame
- skill level and governance budget available to Trustees to assess and monitor each strategy:
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Step 7

Determine how the board will select each manager for each segment of the process and what criteria will be used for evaluating them or removing them.

Step 8

Determine how the overall strategy can be cost-effectively managed and monitored over time to stay on target at all times.

"Over 90% of the fund's final results will be determined by the trustee's overall, long term asset allocation policy…Only after these decisions are addressed should the trustee focus on the related challenges of manager selection. All too often, however, trustees focus more time and attention on manager selection than on critical policy decisions."[7]

There is no greater cost to a fund than the cost of change. Take the time at the start to structure it right