The secret to success

Tim Giles of Aon explains why being ‘active’ is key to improving your pension scheme’s outcomes

Being ‘active’ is more than just investing in active managers. To optimise your scheme’s outcomes, you need to be active across a number of areas. We have identified seven key areas where trustees can be active or can ensure someone is being active on their behalf:

Asset allocation

Asset allocation has a big impact on investment returns. This is about more than actively managing allocations across the return-seeking or matching portfolios. Allocations within each asset class portfolio should also be actively managed, based on investment opportunities and risks in the market. For example, are you dynamic enough to consider and implement new strategies like bank loans or asset-backed securities within your fixed income portfolio? Or could you diversify your equity portfolio to include new lower-cost approaches such as factor investing? Active asset allocation across portfolios can allow trustees to benefit from better risk-adjusted returns compared to just strategic allocation.

Investment managers

Being active with manager selection can have a material impact on the net of fees returns, so review your managers regularly. Change may also be required urgently – for example if a manager is downgraded due to a major incident. You need an active process to ensure your managers remain best-in-class or to be able to replace managers in a cost-effective and timely manner.

Operational due diligence (ODD)

ODD can have a significant drag on performance if it is done incorrectly, or worse still, not done at all. ODD should not be a review of a manager’s investment capability. Instead it should investigate the operational structure that enables their investment capability to be deployed. ODD can be time-consuming and costly – who is doing this on your behalf? For example, who is checking that each manager is obeying trading limits? Who is responsible for background checks on staff? Are these one-off or continuous?

Governance

Governance practices have a direct effect on the decisions trustees make. Think about your meeting framework and whether you have enough time to focus on strategic issues. Challenge your advisers with deceptively simple questions like “What are the alternatives to this recommendation and why have they been discounted?”. Recognise the important role of the chair to manage the strengths, personalities and dynamics of the trustee board, being mindful not to fall into behavioural issues such as ‘groupthink ’or a dominant voice where one person drives the agenda and decisions.

See www.aon.com/trustee-effectivenessuk/

Fees

On the whole, we are pretty good at managing our personal money; we know our outgoing expenses and can haggle for better prices. When it comes to a scheme’s charges, can you comfortably itemise all the fees that you pay? Can you be sure that the fees you are paying are as low as they can be? What services are you getting for your money? Actively seeking out greater transparency in these areas and negotiating fees where appropriate, will help seek better value for money.

ESG

Environmental, social and governance (ESG) matters are moving further up trustees’ priority agenda as a way to better manage risk and generate sustainable, long-term returns. We believe trustees can be active in encouraging better long-term behaviours in the companies in which they invest. This can involve:

- Raising awareness among key stakeholders;
- Understanding beliefs and how these apply to the scheme;
- Documenting policies and objectives;
- Modelling scenarios such as climate change;
- Engaging with managers to understand their approach.

Risk management

We believe trustees can tackle risk management with a three-step active approach: Understand, Measure, Mitigate. Understanding the areas that could cause their scheme to be in jeopardy is vital. Potential risks could include liquidity, sponsor covenant, underlying managers, cyber, etc. Measuring those risks, giving them a probability of occurring and estimating the impact on the scheme can give you a sense of the size of the risk. Next is to decide whether to run that risk or mitigate it. Mitigating manager risk for instance could involve carrying out further ODD or employing more managers to diversify concentration risk.

Being active in today’s environment encompasses multiple disciplines but is central to improving scheme outcomes and navigating hazards. How active are you in these areas? Where can you be more active and where can you challenge others to be more active on your behalf?

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