Demystifying investment jargon for trustee boards

"There is no sphere of human thought in which it is easier to show superficial cleverness and the appearance of superior wisdom than in discussing questions of currency and exchange" – Winston Churchill

Is there is a positive correlation between good governance and investment performance? Yes - according to some academic research[1] which contends the figure might be as high as 2.4% annually. Either way, there is much anecdotal comment to support this view. While good governance cannot guarantee improved investment outcomes, it can certainly improve the chances.

However, how often do you hear trustees say: "I find it difficult to understand investment information," or: "I get confused so quickly by investment jargon and terminology?" Yet it is difficult to imagine a worthy governance process without proper understanding by the trustees of the schemes investments.

How well are many trustees really equipped to:

1. Understand both investment consultants and managers?
2. Have a constructive dialogue with them?
3. Monitor, supervise, and challenge them?
4. Mitigate risks of reputational damage or investment related litigation?

"We are drowning in information, but starved for knowledge." John Naisbitt

Investment reports and communications are certainly not light reading. Do they transfer knowledge as opposed to providing information to satisfy regulatory and compliance requirements? The reality for many is that properly understanding investment reports is very difficult and takes considerably more time than they readily have.

While there is much in the investment world that is technical and difficult to understand, that does not mean it cannot be explained. There are some generic questions that can help trustees put some shape on their response when information is presented to them:

1. What has performed best, i.e. which asset classes, regions, strategies, irrespective of benchmark?
2. Were we there?
3. What will perform?
4. Will we be there?

For each security category or fund in the portfolio:

1. What is the investment objective?
2. Does it complement the agreed investment strategy?
3. Are there excessive accumulated concentrations?
4. What is the benchmark?
5. What is the performance of benchmark?
6. What is the standard deviation of benchmark?
7. What is the performance vs benchmark?
8. What is the standard deviation vs benchmark?
9. What are the total costs?
10. What is the liquidity?
11. What is the leverage?

This list is, certainly, not exhaustive. But this reactive approach often reflects a lack of control by the trustees. They are trying to understand and discuss information and terminology as it is presented to them in another party's format.

Too often these discussions take place in a group environment in which the ability to understand answers and clarifications, at the very least, will vary. Trustees won't have as much control of the sequence, pace, or the detail of answers as they might. Also, this process has limitations as a means to achieve genuine knowledge and understanding as it typically assumes the trustees are already knowledgeable and confident, which is very difficult if they do not have the time to prepare properly.

While some discussion and challenging takes place, the agenda is often random, uncoordinated, and is led by one, or a minority of individuals. How well prepared are those who are most articulate? Do they actually understand as much as they appear to? The investment world is a vast subset of a vast financial world, and many, even with experience in other areas of the financial world, quickly become less surefooted in the investment space.

How complete is their evaluation? Is understanding across the group properly monitored? Do many remain ill-equipped to discuss these issues at subsequent meetings? Are such exchanges likely to be deemed good governance? Is this a truth facing many trustee boards? ▸

James Meenan
CEO
JNM Investment Governance

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"Men occasionally stumble over the truth, but most of them pick themselves up and hurry off as if nothing ever happened." Winston Churchill

TIME

Today, time is a major issue for almost everyone. How much does a lack of time impair trustees understanding and confidence? A telling survey was carried out by Russell Investments of 300 pension funds in 2012, to ascertain the actual time trustees and their investment committees spend on investment issues. Including both trustee and investment committee time, the average figure was 15.6 hours per annum.

Trustees in the largest schemes spent on average 25.7 hours per annum and the smallest 7.5 hours. Larger schemes typically ran more complex strategies with multiple specialist managers. The report makes a 'tongue in cheek' surmise, that many can spend more time in any year making tea than on investment issues.

Time is the root cause of significant problems for pension trustees. Just look how many full time investment professionals struggle to get it right all the time. What chance so for trustees with so many other responsibilities and priorities? However, if adequate time is not made available, governance is a non-starter. Acknowledging the problems due to a lack of time can be a very useful first step.

CONTROL, PLAN, PREPARE

The immediate tendency can be to heap blame on the source of the problem i.e. the consultants or managers. However, often context and clarity are required to communicate the 'right information' in the right way so that the intended message is the one that is actually received. Is the 'right information' actually being asked for?

BP Pension Trustee Ltd Chief Executive, Sally Bridgeland, a former consultant, spoke at this year's NAPF conference[2]. She said: "One thing that I have taken from school and translated into my work as a consultant and in-house is always do your homework. You need to be very clear on what the exam question is, what is it you're asking them to do and making sure they deliver."

Take control of the communication process. Ensure that the relevant information is read properly. If the trustees just do not have the time, consider outsourcing this to an external party who can make the time available. Review the background of this party as it is very difficult for even the best intentioned professionals to structure an objective view of their own work, particularly on an ongoing basis. Prepare an agenda for objective discussion and clarification.

CONFIDENCE

Thereafter, consult with all the trustees to ascertain issues or concerns they may have and add them to the agenda. Offer this consultation in confidence to overcome the issue of not being totally open in groups. If individuals are restrained by a lack of understanding or a reluctance to ask questions, their potential contribution to a healthy governance process will be extremely limited.

Submit the agenda to the consultants or managers in advance of a meeting. Base the conduct of the meeting on this agenda, and brief trustees in advance so they all understand why different questions are being asked. The trustees will then not just have control over the matters being discussed, but, crucially, they will control the sequence and the pace at which the information is presented.

SIMPLICITY and FOCUS

Planned agendas can be simplified and focussed at the trustee's discretion. Given the issues concern their area of responsibility, the responses should lead to a real learning process – and much quicker at that. Discussions should relate to issues about the portfolio as and when they arise, not broader investment issues. These will be different for each scheme and for the individuals within.

COSTS

For those who are concerned about budget, they might reflect what the real costs might be in time.

Do they have an acceptable level for:

1. A lack of time?
2. A lack of understanding?
3. A lack of confidence?
4. A lack of independence?
5. A lack of challenging?
6. Probable investment underperformance?

There is no magic wand to dispel trustees' concerns about understanding investments. However, a clearly defined role to coordinate the flow of investment information and discussion, which reflects the trustee's priorities, will address many of the problems in a structured manner. They drive the process themselves and can access the required information and knowledge as and when they need it. This should save very valuable time at the very least.

1 The Pension Governance Deficit: Still With Us, *Ambachsteer, Capelle & Lum, Rotman International Journal of Psion Management, Volume 1, Issue 1, Fall 2008*

2 *The Guide to Consultants, October 2013, Sally Bridgeland, NAPF Conference 2013*