Competition & Markets Authority

Investment Consultancy Services and Fiduciary Management Services

Response from IC Select

27th October 2017

Table of Contents

IC Select

IC Select was established in 2007 to help pension funds select and oversee their investment consultant and fiduciary manager so that scheme governance, and consequently investment performance, can be improved.

Over the last ten years we have gradually evolved our services. This has involved increasing our data collection capability and developing new reports and services to present insights into, and challenge to, both investment consultants and fiduciary managers. Not all the services have been commercially successful. Whether successful or not, we intend to describe, with examples, the services created and, where they have failed, the reasons why we believe they failed and where successful, the reasons for their success. Some of these services align directly with the potential remedies in your Statement of Issues and, consequently, may be helpful in informing you of the challenges in implementing these potential remedies and their likely success.

Prior to establishing IC Select, Roger Brown, the Founder and Director of IC Select, had established a predecessor company, Blacket Research, set up, following the Myners Report, to benchmark, challenge and, where possible, measure the added value from investment consultants in both strategic advice and manager selection. This company, although initially well capitalised, eventually went into liquidation. Within this response, where related to your objectives, we intend to describe the reasons for this failure and the challenges that exist, or existed at that time, in measuring the advice of investment consultants.

Overall, we draw on our experience from both companies in compiling our response.

Introduction

We would like to thank the Competition and Markets Authority for the agreed extension in responding to your 'Statement of Issues'

This response first addresses the issue of the definition of investment consultancy services and fiduciary management. It then goes on to comment on the scope of the enquiry and suggests further areas that the CMA may wish to consider. We then consider some aspects of the hypotheses for investigation, before finally commenting on the potential remedies where we believe our information may be helpful to the CMA in its investigation.

Throughout our response, we are mindful of the fact that strategic asset allocation is significantly more important to the long-term performance and risk of a pension fund than manager selection. This has been consistently demonstrated by academic research over the years[1] [2]. We have attempted to provide our comments so as to reflect the relative importance of each part.

[1] *Determinants of portfolio performance* by Brinson, Hood and Beebower (1986)

[2] *Asset allocation dynamics and pension fund performance* by Blake, Lehmann and Timmerman (1999)

Definition of investment consultancy services and fiduciary management

For the purposes of the investigation you define:

a) ‘investment consultancy services’ to mean the provision of advice in relation to strategic asset allocation, manager selection, fiduciary management and to employers in the UK; and
b) ‘fiduciary management services’ to mean the provision of a service to institutional investors where the provider makes and implements decisions for the investor based on the investor’s investment strategy in the UK. This service may include responsibility for all or some of the investor’s assets and may include, but is not limited to, responsibility for asset allocation and fund/manager selection.

We broadly agree with the definition of ‘investment consultancy services’ but believe it should include, in addition to strategic asset allocation and manager selection, a separate category of medium term asset allocation. Medium term asset allocation is the overweighting or underweighting of holdings in an asset class. All investment consultants provide advice in this regard which is used, partly, to determine how new cash-flows are invested or how disbursements are realised to maintain an appropriate medium term tactical asset allocation.

The definition of ‘fiduciary management services’ we consider is narrower than the services actually provided by fiduciary managers. Footnote 17 on page 7 of the ‘Statement of Issues’ we believe is a more accurate description of how fiduciary management is provided in the UK. It states, “fiduciary management is an industry term that is usually taken to describe cases where a provider advises clients on how to invest their assets and then makes investments on their behalf for all or some of their assets. These delegated responsibilities can include selecting asset managers and strategic asset allocation. The level of delegation and discretion given can vary depending on the client’s requirements.”

The difference between the definition and the description is that, in the description, “a provider advises clients on how to invest their assets” whereas in the definition they do not. We believe that in fiduciary management, the fiduciary manager will typically provide advice to the client and, consequently, the definition should be changed.

We consider fiduciary management to be of two types:

a) *Full fiduciary management* where the fiduciary manager manages the total assets, or in rare cases a proportion of the assets, against the full liability cash-flows of the scheme. In doing this they will provide advice to the Trustees on the strategic objectives and risk budget. They may also provide advice on liability hedging and strategic asset allocation or this may be delegated by the trustees to the fiduciary manager to implement.
b) *Partial fiduciary management* where a sub-set of the assets are given to the fiduciary manager to manage against an asset benchmark (such as a bond or equity index). In partial fiduciary management, the fiduciary manager does not provide advice.

The provision of advice by the fiduciary manager is an important element of the service in full fiduciary management. For many fiduciary managers, the manner in which the advice is given is closely integrated with the implementation. For example, where strategic advice is provided based on a cluster approach formed by sensitivities to different economic scenarios with the same type of cluster analysis used to select managers and construct portfolios.

We believe, that the provision of advice by asset management firms that offer fiduciary management has had a beneficial effect on competition in strategic advice and has brought new thinking and challenges in strategic advice to the investment consultants.

The definition of fiduciary management is important when considering the potential remedy in paragraph 131 requiring divestiture of investment consultancy services. If the definition of fiduciary management remains as currently and the requirement to divest consultancy services were implemented, then this would preclude asset managers in their fiduciary management services from offering advice. We consider this would be detrimental to the range of services available to Trustees and therefore potentially detrimental to the end investors, the pension schemes.

This does not imply that paragraph 131 is not worthy of consideration. If the definition of fiduciary management were changed, then we would interpret paragraph 131 as a separation of firms providing investment consultancy services from those offering fiduciary management services, albeit with the fiduciary managers continuing to offer advice within their service.

We would therefore recommend that the definition of fiduciary management is broadened to include advice.

Area of concern that warrants further analysis

We believe, that there are two areas of concern that warrant further analysis as part of your review.

These are:

a) The influence of the investment consultants on the Pensions Regulator (tPR)
b) The influence of the investment consultants on the Pensions and Lifetime Savings Association (PLSA)

Investment consultants have been able to operate with little challenge as a result of their role as the gatekeeper for the provision of investment services from investment managers, custodians and performance managers to pension funds. None of these firms publicly criticise an investment consultant for fear of being removed from their buy lists and the consequent impact of this on their revenue. Consequently, there has been no natural balance to the influence of investment consultants with key organisations.

The Pensions Regulator (tPR)

When tPR was established, we understand it was short of the necessary knowledgeable resources to complete all the work required. To fill this gap, the major investment consultancies seconded their personnel to assist tPR. I am not sure if, or to what extent, this practice of secondment still exists. One impact of this was that the seconded investment consultants used their influence to ensure that tPRs training material was aligned with the services of investment consultants.

This impact can still be seen by examining tPRs Foundation Indicative Syllabus (see Appendix I) for the Trustees Knowledge and Understanding. As all trustees are required to work through this training programme, it inevitably has a significant influence on their subsequent approach to managing their scheme. I have not looked at the actual material since 2008, before the 2009 re-working of the material, however, the syllabus suggests that the same consultant bias still exists. This can be seen in section 9 where manager selection is still given significant detail. I would imagine that there is still no mention in the training material of the academic research that shows that consultants are unable to select out-performing managers. Instead the impression is given that carrying out these manager selection exercises, with appropriate advice, will allow trustees to identify out-performing managers.

According to academic studies, strategic advice contributes over 90% of pension schemes long term risk and return with manager selection contributing less than 10%[3] [4]. These findings from academic studies are not reflected in the training provided by the tPR to Trustees. A significant part of the training is focused on how to select and oversee asset managers with little training provided on how to select, challenge or oversee an investment consultant. It is therefore, perhaps not surprising that demand side challenge to consultants may be inadequate.

[3] *Determinants of portfolio performance* by Brinson, Hood and Beebower (1986*)*

[4] *Asset allocation dynamics and pension fund performance* by Blake, Lehmann and Timmerman (1999)

We consider that this lack of balance in the tPR's training material is a direct result of investment consultant firms having seconded their personnel to the tPR to create the training material. Whether the consultant bias in the training material was inadvertently created or deliberate, it is none-the-less there.

Perhaps with better, more balanced training from the outset, trustees will be more challenging about the value added by investment consultants and demand side challenge will, consequently, be significantly improved.

We would recommend that as part of your review you look at the training material of tPR for trustees and the wider influence that the major investment consultants may have on the tPR.

The Pensions and Lifetime Savings Association (PLSA)

The PLSA is perceived as the voice of the industry; speaking up for its pension scheme members. However, the investment consultant firms exert significant influence over its output which again, we believe, undermines demand side challenge to the investment consultant firms.

Part of this influence arises from the significant financial support provided by the major investment consultancy firms in sponsoring the conferences etc. and, also the membership of the investment consultants on the key committees, in particular the investment committee.

The consultants influence on the PLSA provides them with a significant input on the content of conferences and the ability to influence the narrative for their own agenda. We do recognise that it is not unreasonable for this to be the case if they are providing key sponsorship for a conference. However, this again shapes the thinking of trustees on what issues are important for their pension schemes.

Hypotheses for investigation

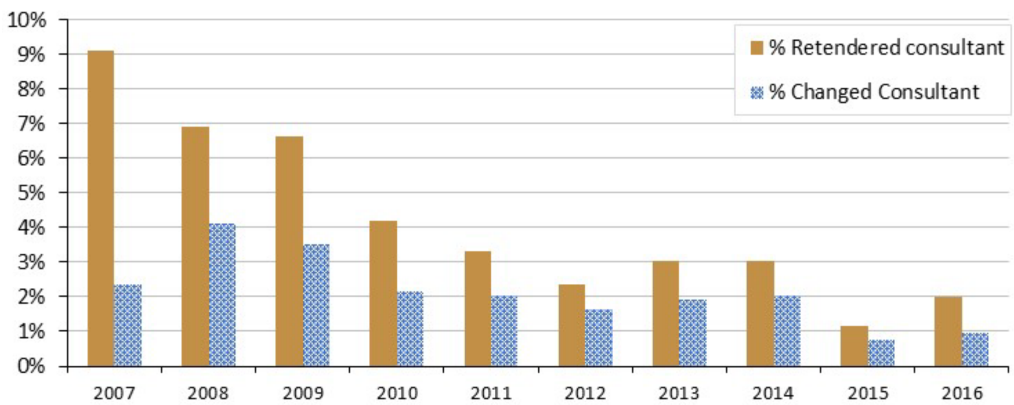
Demand side and information issues

Tendering and switching rates

IC Select have collected data from the major consultancy firms on the number of trustee defined benefit advisory clients, the number that retendered their services in any year and the number of clients lost. The number of schemes covered by the survey in each year has varied between a low of 1,783 and a high of 2,010. In the most recent year it was 1,812.

Chart 1 shows the percentage of clients that retendered their consultancy services and the percentage that changed consultant firm in each year. The client lost data is adjusted for clients lost as a result of schemes entering the PPF and schemes merging. This data shows a clear decline in the amount of retendering activity in recent years.

Chart 1: % of advisory clients retendered and changed consultant



Our expectation, following the financial crisis, was that the rate of re-tendering would increase significantly. We had thought that a large number of trustee boards would reconsider the advice they had received. This advice, which must have contributed to risk levels being higher than required at a time when solvency at schemes was good, will have been a significant contributor to the resultant deficits. Instead, the opposite has been the case with retendering activity declining significantly.

We believe that this decline in tender activity has resulted from three factors:

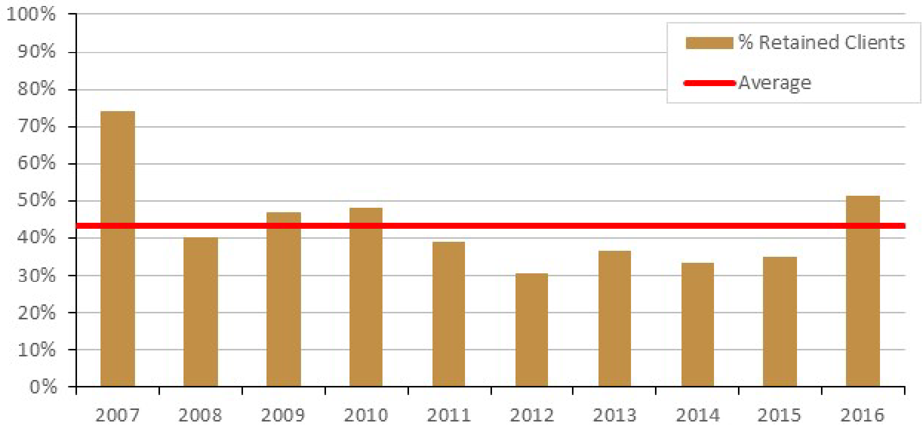
- The strength of the relationship that exists between the investment consultant and the Trustees is strong and makes Trustees reluctant to retender the services of a trusted adviser they have worked with over many years.
- The introduction of long term journey or de-risking plans, in trustees' minds, 'ties' them to the adviser and raises concerns that if they disrupt that relationship they may have to revisit the journey plan and in turn disrupt the progress being made to achieving their Scheme objective.
- The introduction of added investment complexity, particularly in the areas of LDI, alternatives and derivative based risk mitigation techniques, has made trustees more reliant on the investment adviser for the day to day monitoring of the fund. This creates a barrier to changing investment adviser.

IC Select have provided services to assist Trustees select their investment consultant since 2007. Nearly all the schemes we have worked with had assets in excess of £2 billion. The two exceptions to this were, a corporate scheme with assets of £750 million and a local authority scheme with assets of £550 million. Our original expectation was that demand for investment consultant search services would be greatest in the sub £1 billion market where schemes were less likely to have the in-house resource to undertake the work themselves. However, it would appear that larger schemes are more cognisant of the complexities in selecting an investment consultant and, even with in-house resource, will retain expert support. By contrast, smaller schemes appear not to be as aware of the importance of the investment consultant in the long-term outcome of the pension fund or the complexities that underlie the investment consultant's capabilities. Consequently, the Trustees are more likely to undertake the search themselves.

Cost may be a factor in smaller schemes carrying out searches themselves. However, as costs for investment consultant searches are typically around 80% of manager searches this is unlikely. A more plausible explanation is that trustees at smaller schemes regard the potential value added from investment consultant advice to be significantly less than the added value from fund managers, a view not supported by academic research.

Chart 2 shows the percentage of firms that retendered their consultant service, that retained the same consultant. The average number of retendering schemes that retained the same consultant over the ten years is 44% (i.e. 66% changed consultant).

Chart 2: % of advisory clients that retained the same consultant



Over the same period, the number of schemes that retained the same consultant, where IC Select assisted in the selection exercise, was 21% with 79% changing consultant, significantly different to the industry average. We believe there may be three possible explanations for this significantly different outcome:

a) Large sample bias. Our clients typically have assets in excess of £1 billion. These larger funds have more in-house resource and often more expertise on their trustee boards. Consequently, they are less dependent on the consultant than smaller schemes and have more challenge of the consultant in their governance. Chart 2 includes schemes of all sizes. Our data does not allow us to control for a size effect.

b) Schemes that seek the assistance of a third-party evaluator (TPE) are more committed to a genuine selection process and potentially changing adviser.
c) Enhanced due diligence provided by the TPE improves the trustees understanding of the issues that should be considered and consequently a more nuanced decision can be made.

Of the firms selected following a tender exercise conducted by IC Select 56% did not select one of the big three consultants but instead choose a niche or mid-sized firm.

IC Select's experience of re-tendering exercises is, that once a consultant becomes aware that their services are about to re-tendered, they improve their service offering and will often bring a number of new ideas to the Trustees. This would support the view that more frequent tendering will improve the quality of the service provided. However, subsequent feedback from clients, that retained the same consultant, suggest that these benefits are often short lived.

We do not believe that increasing tender rates and increasing the likelihood of changing advisers is necessarily a positive for a pension fund in the longer term since there is a lot to be gained from long term horizons for both investment decision making and advice. Instead, it should be considered that a better approach to creating competition lies in regulation and education.

Demand side challenge

We would agree that the demand side challenge is generally inadequate. We consider that there are three factors that have contributed to this lack of challenge:

a) The evolution of investment consultancy advice
b) The lack of appropriate education for trustees on the importance of the consultant to long term returns
c) Deliberate actions by the major investment consultants to suppress challenge

a) The evolution of investment consultancy advice

When investment consultancy first emerged as a separate discipline at the major actuarial investment firms in the early 1980's, the role of the investment consultant was predominately as overseer of balanced managers. Asset management was a great deal simpler and the investment consultant, other than helping to select and oversee the fund managers, did not offer advice. Asset allocation decisions were, in the main, driven by balanced managers. As the consultants were offering limited advice, oversight and challenge of the consultant was not required. From the late 1980's and through the 1990's the role of investment consultants evolved as they started using more segregated management solutions and bespoke asset pooled funds to implement their client's investment solutions. As a result, they were also now, not only providing manager selection advice, but also advising on the strategic asset allocation of the fund. Their role had changed from being an overseer to the key adviser. As academic research has shown, they were now the key influencer on the long term returns of their clients. The investment consultant's role continued to evolve in the 2000's as liability driven investment became popular and they took on more responsibility for the management of both the assets and liabilities.

We believe that the governance at pension schemes should have evolved to reflect these changes in service provision so that investment consultants were subject to, as a minimum, the same level of scrutiny as asset managers have been subject to, with rigorous selection process and ongoing oversight to identify key changes in the personnel or resources at the consultant. However, there was no commensurate change in the governance framework at most pension schemes.

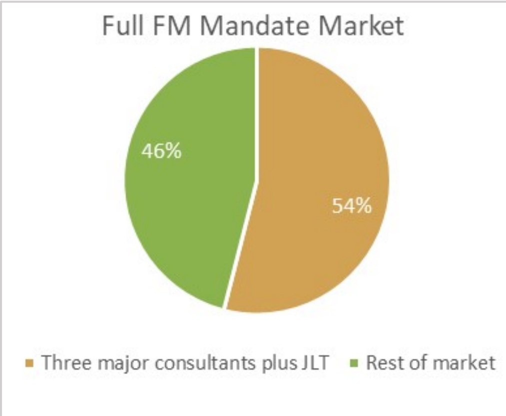
b) *The lack of appropriate education for trustees on the importance of the consultant*
As previously described, a significant part of the training provided to new trustees is based on tPR's trustee toolkit supplemented by additional training by investment consultants. The trustee toolkit presents the investment world from the perspective of the investment consultant and is light on evidence that either highlights the failing of consultants or recommendations on when it is appropriate for trustees to challenge advice or how this might be achieved. Additional training provided by investment consultants cannot be expected to be unbiased in its content or to highlight failings in investment consultants and how to manage these.

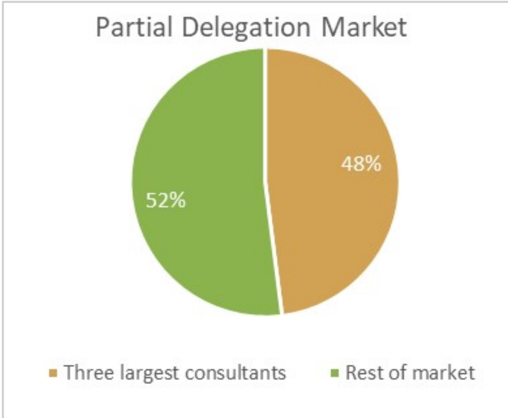
c) *Deliberate actions by the major investment consultants to supress challenge*
Investment consultants have substantial influence in the institutional market place. We believe that they have not always used this influence to encourage challenge. In fact, we believe the opposite is true, some firms have deliberately used their influence to supress challenge. Examples of this include changing agreements to ensure clients cannot use data provided by the investment consultant to measure the effectiveness of the consultant's advice and using their influence to discourage trustees from undertaking independent performance measurement of their services.

Conflicts of Interest

We will only comment on the first conflict mentioned, notably “incentives to steer clients into the investment consultants’ own in-house products/services, in particular moving clients into fiduciary management.”

Based on our research of the 13 largest fiduciary management firms we find that the largest three consultancy firms, each of which offer fiduciary management, together with Jardine Lloyd Thompson, a smaller firm that may also have been active in converting advisory clients to fiduciary management have 54% by number of clients of the market for full fiduciary management and 48% for partial fiduciary management.





We do not consider that the quality of the fiduciary management offering of these consultant firms, when compared to other fiduciary managers, is sufficiently superior to justify this market share (Note: it cannot be inferred from this that the fiduciary management services of these consultant firms are inferior to other fiduciary manager providers). Therefore, we believe that there are two possible explanations for their success:

a) That they have been able to convert existing advisory clients to fiduciary management
b) That brand recognition gives them a market advantage.

It is likely that both these explanations will have contributed to their success in some part. However, there are other fiduciary managers that also have a strong brand that have not been as successful. Consequently, we would conclude that conversion of existing clients to fiduciary management by advisory consultants has been a significant factor in their growth as fiduciary managers to date.

We have observed this process of conversion in practice with several schemes. In each case, the personal relationship with the incumbent consultant has appeared the key factor. One example of this was a large pension fund where we were asked to look at advice to invest in the incumbent managers global equity fund. We provided a shortlist of two other global equity funds run by competitor fiduciary managers. Both of these funds had a better performance track record, greater manager diversification, achieved a lower historic risk level, were more tax efficient, had lower underlying manager costs and lower fiduciary manager fees. None-the-less, the trustees decided to use the fund on the incumbent consultant. Given that the incumbent consultant's fund was inferior to the other two short listed funds in every respect, the only reason we can see for the selection decision was the existing relationship.

Barrier to entry and expansion

There are minimal barriers to the establishment of new investment advisory firms and, over the last decade, a small number of credible players have emerged. These firms typically gain their initial clients from previous relationships with key stakeholders, so initial growth is good. Thereafter, growth becomes more difficult as they have to convince new schemes, where they have no prior relationship, of the merits of their firm. This is typically difficult, as the significant resources of the major consultancy firms would appear, without detailed consideration of the relative research approaches between firms, to give the larger firms an information advantage.

The offerings of both new entrants and established players are relevant for a wide range of pension funds. The decision on which is most appropriate for any specific scheme will depend on the requirements of specific boards of trustees. A bias towards purchasing established brands is to be expected as the same behaviour exists in virtually all markets. Brand recognition takes many years to develop. During this time, new market entrants will benefit more from expert support to trustee boards in selecting an advisor as this support may help to assuage worries with regard niche players.

In fiduciary management there are significant barriers to entry as significant resources are required to establish the operating platform and meet regulatory requirements. Consequently, all new entrants to the fiduciary management market in the UK are associated with established organisations. This association with established organisations normally provides immediate brand recognition. We would therefore expect growth of new fiduciary management firms to outpace those of new advisory firms.

Marketing services to pension trustees

The sales process typically required to sell to pension schemes makes it difficult to speak with the decision makers or bring new ideas to their attention. This is an issue for firms like IC Select, that seek to promote services that potentially challenge the incumbent consultant, and we would expect, also an issue for new consulting firms seeking to build market share.

To promote a service to a pension fund, firms typically meet with a full-time employee of the sponsoring company, typically the pension manager, pension secretary or personnel manager. These people are often not trustees of the pension fund. The opportunity to speak with the key decision makers, the Chair of Trustees or the Chair of the Investment Committee are limited.

Trustee Boards have very full agendas and it is difficult to get time at a meeting to discuss a new idea unless the trustees themselves have requested to look at an issue in more detail. Getting new concepts onto the agenda typically depends on the full-time employee of the company persuading the Chair to devote time on the agenda to the idea. Even when the employee has appeared to be enthused by a new idea, in our experience, they have rarely been successful in getting this on the agenda. This failure to be able to present to the trustees has been a major influence in our advisory client base being almost exclusively with funds with over £1 billion assets, since, at these firms, the in-house teams have discretionary budgets to buy services.

We assume that the same will be true, to some extent, for new advisory consulting firms that are bringing new ideas and approaches to pension trustee boards. They will rarely be given an opportunity to present directly to trustees, providing challenge to the existing firm

Furthermore, if a consultant selection exercise is managed by either the trustees or the in-house team then we would expect them to shortlist the major firms. The possibility of them having sufficient information about, or the confidence to recommend, a new firm for consideration is small.

By contrast the incumbent consultant attends all trustee meetings and has the opportunity to present new ideas and influence the trustees to implement them. They will also almost certainly be included by the trustees in any short-list to select an investment consultant and, rightly so. The challenges to new firms developing an advisory business are consequently significant, particularly if trustee boards are not using third party services to help them in the selection.

One new consulting firm has been successful in rapidly developing a large number of advisory clients in recent years. The firm does have a distinctive proposition, but we believe their success has also resulted from effective use of social media to rapidly develop awareness of their brand.

Potential Remedies

We have provided comment on a number of the possible remedies suggested in the Statement of Issues. Overall, we consider that enhanced education and training and improved performance and fee benchmarking will be the most effective way to address any competition concerns.

Education and training should ideally be created independently of service providers with academics, and investment writers producing the material. However, this will take a long time to change attitudes amongst trustees and the commercial realities of the sector will make it difficult to achieve, even amongst the key regulators and trade bodies.

We have suggested a number of enhancements and initiatives all of which we believe can be fully implemented within two years. Key amongst these is the Footprint Concept which, in its final iteration, has the capacity to bring together performance and fee benchmarking information with high level investment structures and differing governance models to create meaningful challenge of investment consultants. We believe that if the challenge to investment consultants is improved then tendering will increase and greater competition amongst consultants will emerge on both cost and service quality.

To support the Footprint Concept we have also recommended:

- The introduction of an annual investment cost report
- The introduction of benchmarks for fiduciary management
- An approach to standardising the performance calculation for advisory clients
- The introduction of benchmarks for advisory consultant performance

Remedies for fee benchmarking

Assessment and comparison of fees between firms is important for assessing the value added by a service but, in practice, challenging to achieve. In recent years, IC Select have developed templates to assist in the comparison of fee quotes in advisory selection and fiduciary manager selection exercises and, also, built a fee benchmarking database for advisory oversight work. These approaches have had different degrees of success.

Advisory Management Fees (Selection)

Endeavouring to compare fees when selecting an advisory consulting is fraught with difficulties. This is not wholly the fault of the advisory consultants, but often results from the tendering firm being unable to quantify precisely their requirements. For example, until a strategic exercise is started the trustees are generally unable to specify what will be involved and they are often unsure how many manager selection exercises they will require.

Fees can be requested for different elements of the service (e.g. strategic study, manager selection exercises for different types of mandate, producing text for the Report & Accounts, SIP review) and then combined into a basic template of the requirement. The difficulty in doing this is attempting to define what is required from a strategic study where fees can vary from as low as £20,000 for a basic study up to around £200,000 for a full study if ALM modelling for a number of different possible portfolios and with different assumptions. This is not ideal as the most important element, strategic advice, is the most difficult to quantify and the elements that can be quoted reasonably accurately, such as manager selection and updating the SIP are of lesser importance.

One approach to managing this fee issue is to request fixed fees with the investment consultant taking the risk of more time than expected being needed and benefiting if less time is required. Fixed fees have the added advantage of removing conflicts of interest that exist from providing advice that can generate additional fees. Generally, the larger consultancies are reluctant to embrace all you can eat fixed fees, and will caveat the fixed fee with the right to charge additional fees if more work than is expected emerges. By contrast, the medium and smaller consultancies and the new challenger firms generally welcome fixed fees.

Advisory Management Fee Benchmarking (Oversight)

Five years ago we created a database of fees charged by consultants for different service aspects to use with clients in providing oversight services and benchmarking their fees. We now no longer offer this service as we considered it offered no or very limited value to our clients.

Despite the database having a significant number of entries, small changes in the service provision could have a material impact on the fee. This was particularly true in strategic advice, but also there were challenges in such areas as quarterly reports where different reporting requirements could lead to material differences in costs. As a result of these differences either usable sample sizes became small or the there was a lack of homogeneity in the sample. The approach worked best in clearly defined areas such as manager research and providing copy for report and accounts. However, as these were the least material part of the service we felt overall that providing this analysis was misleading to our clients and stopped the service two years ago.

We do believe that granular fee benchmarking would be helpful if it could be achieved. We cannot see how this can be done but would welcome initiatives in this area.

Annual cost reporting

It is surprising to us that few pension funds we have worked with, irrespective of size, know the annual cost of managing the investments of the fund. One of the main reasons for this is that some costs are deducted directly from funds whilst others are invoiced. The costs deducted from funds are often not identified by trustees.

It would be an easy improvement to scheme governance if pension schemes were advised or mandated to receive an annual report of the full investment costs of the fund. This report would cover consulting costs, underlying manager costs, fund costs, custody costs, in-house investment costs and legal costs relating to investment issues. Once an industry agreed method for calculating transaction costs is agreed, transaction costs should be added to the report.

Consulting costs should be separated between core costs and project costs, if time cost charging is used, and with manager selection costs identified separately. Fund costs should be separated by asset category and investment approach e.g. passive or active. All costs should be presented as both a cash amount and as a percentage of funds.

Improved awareness of costs will inevitably lead to trustees questioning whether this represents value for money and how their costs compare to other similar funds.

We consider that the best placed advisers to produce and deliver this report are the investment consultants, since they already have access to most of the information. If greater impartiality were desirable then the actuary or an independent third-party evaluator could provide the report.

This change could be easily and effectively implemented at minimal additional cost using the existing adviser structure.

Proposed Fee Benchmarking Solution for Advisory Management (Oversight)

Fee benchmarking is possible and this can be related to strategic advice with the co-operation of the advisory consultants.

As stated above we cannot see how granular fee benchmarking can be achieved in a cost-effective manner. However, we consider that it is possible to benchmark fees both within and between advisory firms if data is viewed at an aggregate level rather than in a granular approach. Furthermore, this can potentially be related to the investments of funds and their performance.

Consultant Footprint Concept

We are developing a concept that can potentially benchmark fees, give trustees the information they require to challenge their investment advice, benchmark performance and allow assessment of value for money. Furthermore, we believe that this can be cost effective for all schemes, even those with assets of less than £10 million. This is referred to as the Consultant Footprint Concept in this document. (Details are included in Appendix IV)

Since the success of this approach will depend on the co-operation of the investment consultants we are now starting to meet with the consultants to discuss its feasibility. If the consultants are supportive we believe it will be possible to have the approach in place by the end of 2018 or early 2019.

Fiduciary Management Fees (Selection)

We support full disclosure of all costs earned by the fiduciary manager, underlying asset managers and custodians during a selection exercise. We are comfortable that we achieve this in all selection work we do. Any fiduciary manager that does not provide full granularity of their fees will be excluded from the process.

However, even with full disclosure of fees caution needs to be applied in comparing the fee proposals of fiduciary managers. Paradoxically, the fees quoted in a fiduciary management selection exercise are directly dependent on the calibration of the fiduciary managers risk model.

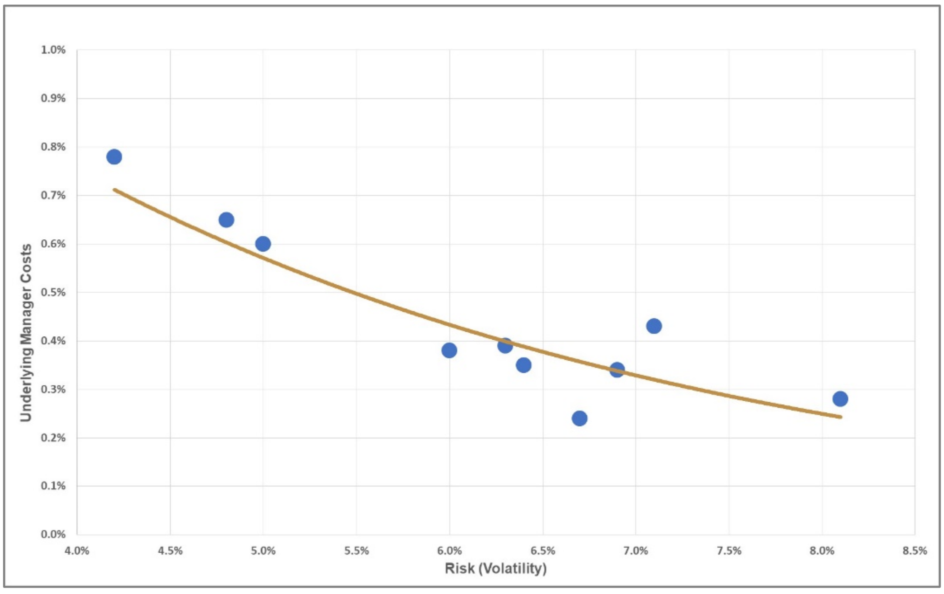
Those managers with high return expectations will be able to achieve the client's return objective with less invested in growth assets. As growth assets are more expensive than matching assets managers, those managers with high growth forecasts will therefore have lower fees. In advising on a selection exercise we will pass through several iterations on fees in order to this adjust for this effect. Therefore, we believe that comparing generic fees published on a consultant's website to understand the lowest cost manager would be misleading.

Fiduciary Management Fee Benchmarking (Oversight)

The cleanest area to carry out assessment of fees is in fiduciary management, although even here considerable caution is required in interpreting the information and deciding if the proposition represents value for money. As fiduciary management is a reasonably clearly defined service and as the service propositions are broadly similar between firms, comparison of fees can add value; although direct comparison, without appropriate adjustment, will be misleading. The major issue is that the degree of risk diversification will impact on cost.

For any given level of required return, the cost of the fiduciary management solution will be more expensive the greater the degree of risk diversification. Compounding this problem is the fact that the relationship between cost and risk is not linear. As part of the regular IC Select due diligence on fiduciary managers we benchmark the level of fees on an annual basis. Unlike other fiduciary management fee services, we do not define the assets the fiduciary manager must invest in. Instead, we provide a solvency level and return target and require the fiduciary manager to deliver and cost their model portfolio. Chart 5 plots forecast risk (volatility) versus underlying manager cost for a portfolio targeting liability plus 2.5%. As can be seen, the lower the level of risk the higher the cost. Consequently, caution must be applied in endeavouring to compare costs between fiduciary managers and, therefore, the value of cost disclosed on managers websites will be misleading without informed interpretation.

Chart 5: Forecast Risk Versus Underlying Manager Costs



Standardised Performance and Performance Benchmarking

Fiduciary Management Performance Standard

Until recently the provision of performance information for fiduciary management was at the discretion of each fiduciary manager. This led to different methods of calculating performance and different approaches to displaying the data. In addition, the fiduciary manager had full discretion to choose the performance track record they presented. Whichever approach was used, it is almost certain that the fiduciary manager would 'cherry pick' one of their best performing track records, regardless of whether this was relevant to the circumstances of the fund requesting the information.

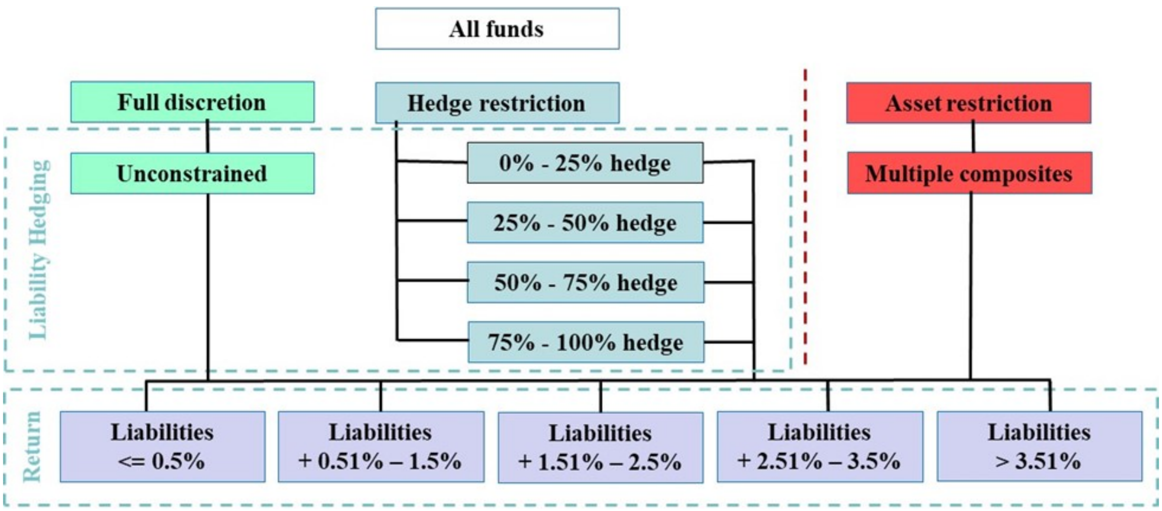
The introduction of the IC Select Fiduciary Management Standard (the Standard) has now ensured that all firms use consistent calculation methods, use composite data, clearly articulating how each composite is defined and, whilst still allowing discretion as to how performance information is displayed within the text of a document, requiring a standardised layout of performance, including both risk and return data, in an appendix (See Appendix III for information on the IC Select Performance Management Standard)

Adoption of the Standard is voluntary for fiduciary managers. However, all the major fiduciary managers have stated that they will comply with the Standard from the start of 2018.

The Standard has been created based on an agreed principle of net returns relative to the client's liability benchmark, with either the full liability or a liability hedged benchmark being used.

Each fiduciary manager has the freedom to determine their own composites. However, the managers are being encouraged to comply with the recommended composite structure shown in diagram 1, although we recognise that some may create more granular composites than that shown below and use the advised structure as umbrella composites.

Diagram 1: Recommended structure for the IC Select FM Performance Standard



It is important to note that the performance track records remain the property of the fiduciary manager. These are freely available to any pension scheme that requests the data from the fiduciary manager or any 'qualified' enquirer. However, there is no requirement for a fiduciary manager to make their performance track record publicly available. This is in-line with the CFA Institutes procedures for the disclosure of Global Investment Performance Standard (GIPS) track records. The inclusion of performance records in league tables is discouraged for the reason set out below.

League Tables

It is clear that there is significant demand from both journalists and investors for the publication of performance information and the creation of league tables. We consider that the value of such league tables is more focused on selling more copy than on improving the decision making of trustees.

As was stated in the FCA Asset management study preliminary report "past performance has limited value as an indicator of future performance". Given this position, it is difficult to understand how the publication of comparable past performance information would benefit investors.

Past performance is a poor guide to future performance as it is difficult to know whether it has occurred as a result of luck, skill or investment philosophy. There are some fiduciary management firms that, as a result of their investment philosophy, would always seek to fully hedge interest rate and inflation rate risk, whilst others, will endeavor to form a view of the direction of interest rates and set their hedging level accordingly. Given the fall in interest rates over recent years those that hedge 100% of liability risk will currently be at the top of any league table. However, if interest rates were to rise over the next few years these firms are more likely to appear at the bottom of any league table

Fiduciary management performance benchmarks

Whilst we do not believe that creating league tables has any merit we do accept that the creation of fiduciary management performance benchmarks would provide valuable information and enhance the governance of pension schemes.

The creation of benchmarks based on median fund returns from a universe of funds is widely accepted in the industry, with such benchmarks being used, for example, in property and hedge fund management. A similar concept could be used for fiduciary management. IC Select currently receives all monthly data for each composite from each of the fiduciary managers as part of the verification of compliance with the performance standard. Once the initial data to the end of 2017 is received in Q1 2018, benchmarks for each of the composite categories shown in Diagram 1 could be produced shortly thereafter. These benchmarks would be back dated to at least 2010, giving, at a minimum, an initial five-year history. The benchmarks would have monthly values.

At present we do not have permission from the fiduciary managers to use the data supplied for this purpose as the data is supplied only for verification with the standard. Assuming permission is given by the fiduciary managers to use the data to create benchmarks and the fiduciary managers are compliant with the structure in Diagram 1 then it will be possible to produce benchmarks. This will improve the oversight of and challenge to fiduciary managers by trustees.

Advisory Consulting Performance Standard

So far there is no standardised methodology for measuring and comparing the performance of clients under advisory relationships. The key reasons for this are

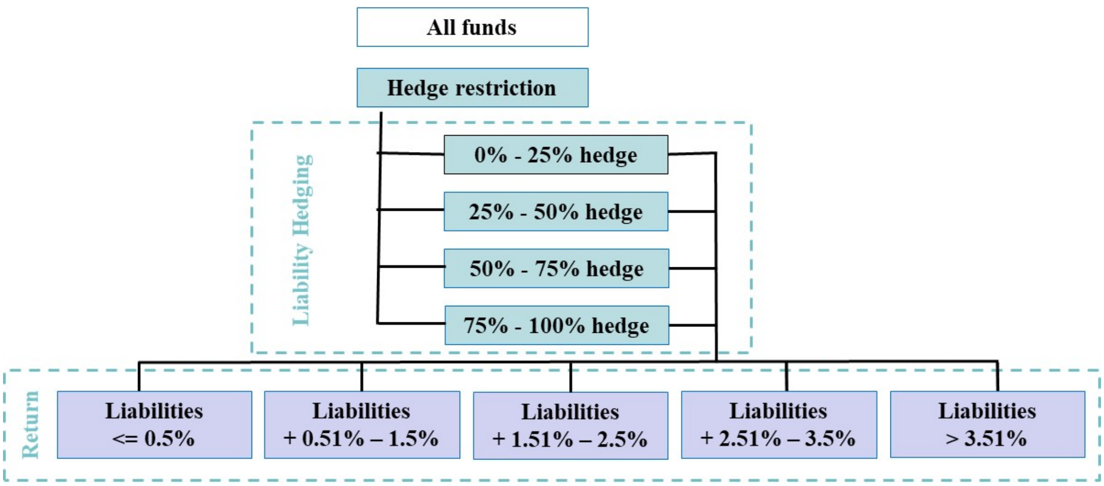
- Difficulty separating the consultant's advice from the decisions of trustees.
- Significantly different investment solutions between funds with different objectives and liability hedging.

We note the desire expressed in the Statement of Issues for an industry standard benchmark for relative returns and the need for a standardised methodology for measuring and monitoring the performance of funds under advisory relationships. We believe this is achievable and that the principles of standardising performance measurement developed for the IC Select Fiduciary Management Performance Standard can be applied more widely.

The difficulty of separating the consultant's advice from the decisions of trustees is liable to represent the greatest challenge presented by consultants rather than the calculation methodology. We see this as a surmountable challenge. Our perspective is that the objective is to measure the success, or otherwise, of the governance approach. As a result, we would not seek to separate the consultant advice from the trustees' decision, but instead consider the outcome as a collegiate decision. If the trustees have not followed the advice, and this has resulted in a different performance outcome, then we regard this as a failure of the consultant to present their advice effectively and a weakness of the governance approach. It is therefore valid to look at the overall outcome.

Each fund would need to be aware of their own performance under methodology. To facilitate comparison and benchmarking, as with the Fiduciary Management Performance Standard, information could be presented in composites that reflect different return and hedging objectives.

Diagram 2: Possible composite structure for an advisory performance standard



The structure of these composites would be different to the fiduciary management standard. Our initial thought is that a recommended composite structure for advisory management would be as set out in diagram 2. However, given the larger number of funds in advisory arrangements it is possible that the composite definitions could be more granular than shown here. The composites would form a basis for comparison between consulting firms.

We believe that an advisory consulting performance standard could be implemented within a year to 18 months. The biggest risk to this timetable is gaining the acceptance of the investment consultant firms to the approach. We learnt from developing the IC Select Fiduciary Management Performance Standard that there can be reluctance to standardised measurement, as it can open firms up to greater scrutiny and competition.

Advisory performance benchmarks

Once the performance of funds is organised into composites, benchmarks could then be created for each composite. Individual funds could then compare their consultant's composite performance with the relevant benchmark to judge how their consultant was performing relative to other firms. They could also assess their own fund's performance against their consultant's composite performance to assess how their fund was performing relative to other clients of that firm.

The proposed Footprint concept could potentially take this further and enable each individual fund to create a customised composite based on their own governance model and asset allocation decisions. Benchmarks for these customised composites could then be created for the incumbent firm and other firms.

Linking performance to asset allocation

The creation of composites as shown in diagram 2 identifies performance based on high level asset allocation, in particular the hedging level and return objective, thereby establishing a link between the advice provided by the consultant and the outcome.

The Footprint concept potentially has the ability to allow a more granular link between asset allocation and performance taking into account not only the hedging position but also a more granular view of asset allocation. This may be achieved by creating clusters of funds with similar asset allocation. Performance of these clusters could then be compared to bring insights into the link between asset allocation and performance. At present we are cautious on the likelihood of success of this approach since it would be dependent on the granularity of the data that investment consultants provided.

Reporting of manager selection performance.

The value added from manager selection is easier to determine quantitatively than from strategic advice. As already stated the key issue in advice is not how good or bad manager selection is but how effective the strategic advice has been. Publishing manager selection performance, without any balancing information on effectiveness in strategic advice could lead to perceptions of the effectiveness of the investment consultant's ability that are spurious. It is therefore essential that education of trustees is improved to prevent this from happening and that significant health warnings are added to manager selection performance results to ensure that they are not taken out of context.

The method used by most investment consultants, including the three major consultancy firms, to measure their skill in manager selection is statistically flawed, inappropriate for pension trustees and, consequently, misleading. The approach is based on creating theoretical portfolios for each asset class based on the consultants buy list of managers (the 'model portfolio approach') and removing managers from the buy list following a downgrade. Depending on the firm, these calculations are made either on a gross of fees basis or after adjustment for a notional fee element. An alternative approach, used by a minority of investment consultant firms, is based on their client's actual performance experience in different asset classes (the 'actual client approach'). This we consider is less misleading and better reflects the impact and implementation of the investment consultant's advice.

Since the model portfolio approach was first introduced, around 2000, the consultants adopting this type of approach have mainly show consistent added value in most asset classes. This apparent added value is contradicted by the evidence from many other sources. For example:

- The State Street Analytic (formerly The WM Company) universes consistently showed the median fund under-performing the market in virtually all equity universes. A contradictory outcome if the consultants indeed had skill in selecting managers.
- The Blacket Research Manager Selection research in 2006 based on actual consultant short lists, found that the consultants' skill in selecting managers was no better than random selection
- Academic research (e.g. Goyal and Wahal and Jenkinson et al) has failed to identify any evidence of skill in manager selection.

Model Portfolio Approach

This is the method proposed in the UILs by the major consultants for demonstrating their skill in manager selection. This methodology fails to capture or present the consultants added value, or lack of it, as applied to advising pension schemes.

When a pension scheme selects a fund manager the investment consultant will typically provide them with a shortlist of managers to choose from and the trustees will select one manager. Where a single selection is being made, with a view to an appointment over several years, then a very high degree of skill is required, as the selection must to be right first time.

The model portfolio approach is based on measuring the consultant's ability to select a panel of advisers, not a single manager, and requires a lower level of skill to be successful than if you are attempting to select a single manager. For example, if you are making 100 selections, you would only require around 55 to be good, to be successful in demonstrating outperformance (i.e. 55% success rate in manager selection decisions). However, a 55% success rate is little better than random if a single manager is being selected for a fund. Consequently, the model portfolio approach allows consultants to demonstrate skill even when this skill is inadequate for the role they are being asked to fulfil.

Furthermore, the consultants intend to only measure the performance of those managers that remain on their buy list and remove them from measurement once they are downgraded to a hold. This is different to their advice to clients where they would recommend remaining invested with a manager if it was downgraded to their hold list. Clearly, they are endeavouring to measure something that is different to the advice they give to their clients. Consequently, we do not consider that this is useful information for clients assessing whether the consultant has relevant skill to advise on manager selection decisions.

Actual Client Approach

We believe a better indicator, is for consultants to show the actual results achieved by their clients from manager selection by asset class. For example, they would calculate the equally weighted performance of all clients with an active European Equity mandate.

Measuring in this way would mean that if the consultant had recommended the same manager to most clients, that manager would have a high weight in their performance statistics. The temptation for consultants may then be, to ensure that their manager selection risk is diversified across a large number of managers, to suggest a wider rosta of managers across their clients, which could mean that not every client was receiving their best advice. To control for this, consultants should also be required to provide information on the concentration of managers (number) of different managers recommended in a year and the frequency with which they were recommended to demonstrate their conviction in particular managers.

Insufficient and/or ineffective tendering and market testing

Mandatory tendering

The introduction of mandatory tendering offers the possibility of improved competition between firms. In our view, this would also be dependent on the introduction of strict rules around how a tender process should be operated. However, even with strict rules, we are sceptical as to whether this would have the desired impact on competition.

A mandatory tendering regime would require trustees to re-tender their investment consultancy services even where they have no intention in changing consultant. Mandatory tendering already exists in the local authority consultant services market. However, in our experience many of these local authority exercises are insincere and, consequently, the benefits are limited. Furthermore, they commit firms that enter the tender process to devoting significant resources to preparing their tender, resources that could be better employed in other work.

There would also be a question about whether other consulting firms would tender for the work if they did not believe it was a genuine open tender. If sufficient quality firms could not be persuaded to tender then the value of a tender would be limited.

There are benefits in maintaining the same consultant and significant hidden costs involved in changing consultants. A consistency of advice and investment approach over the long-term, if successful, should be maintained. Mandatory tendering could potentially remove the benefits from this. Furthermore, a change in consultant will inevitably be followed by a transitioning of the portfolio as the structure of investments are changed to fit with the new advice. If the previous approach was not detrimental to achieving the long-term objectives of the fund, then changing adviser would incur cost with no guaranteed benefits. This would be to the detriment of schemes.

Improved performance and cost assessment and benchmarking, as previously discussed, would naturally produce more tendering if trustees became dissatisfied with their current adviser. Such tenders would then be genuine tenders where the trustees were looking to potentially change adviser and improve the governance of their scheme.

In our view, mandatory tendering is no substitute for improved performance and cost benchmarking, as suggested in the Footprint concept. The emphasis, we believe, should therefore be on better education and information, which if effective will increase tendering where and when it is required.

Industry standard rules for tendering

The current position, at some schemes, where the investment consultant assists the client to retender the services should be stopped. This assistance can vary from suggesting firms to short list, defining requirements and producing the invitation to tender document. Standard rules around the need to attract multiple bidders; the parameters of the tender documents and the selection criteria we believe would be beneficial. The inclusion of tendering of investment consultancy services under a section 36 of the Pensions Act 1995, as discussed below, would we believe be particularly beneficial in this regard.

Remedies to address conflicts of interest

The Statement of Issues suggested three potential remedies if a conflict of interest is found in firms offering investment consultancy services that also offer fiduciary management. These were:

a) Require investment consultants to give greater clarity to trustees that they are moving into a different arrangement and that they could seek this service form other firms.
b) Require mandatory tendering of fiduciary management services
c) Prohibit investment consultants from providing fiduciary management to their clients.

In addition, one potential remedy shown under remedies to address barriers to expansion is also potentially relevant here. That is:

d) Require divestiture of investment consultancy services.

Requiring consultants to give greater clarity to trustees that they are moving to a different type of service largely describes the current position. We do not consider that this has been successful in managing conflicts of interest up to now and, therefore, we believe it should not be adopted.

At the other end of the scale a requirement to divest investment consultancy services in our view is not in the interest of the wider market. Consultant firms that also provide fiduciary management utilise the same core research to provide their services. If they had to divest one side of their business and could no longer depend on the core research that underpinned their service then this would be significantly detrimental to the clients that depended on the divested service.

Both mandatory tendering of fiduciary management services and the prohibition of investment consultants providing fiduciary management services to the clients have the potential to address the conflicts of interest that may exist when firms offer both services. On balance, we consider that the second option would be more successful in this regard.

Even if mandatory tendering also required the use of a third-party adviser to run the tender process it would still fail to fully address any potential conflict where a client was considering from an advisory relationship to a fiduciary relationship. This is because there would not be a level playing field for the tender, as the incumbent investment consultant would enjoy an advantage over the other bidders. This advantage arises from the fact that the incumbent consultant has a good knowledge of the client, will also have, on several occasions, introduced their fiduciary team to the client ahead of the tender so that they can pre-sell their tender and that they have an existing personal relationship with the client that will potentially bias the selection.

As previously mentioned, we have seen the impact of this advantage where the client has selected a product that is inferior in every respect with regard to the other short-listed products. Our only explanation for this is that advantage gained from pre-selling the firms fiduciary services and the strength of the personal relationship has distorted the selection.

If mandatory tendering is considered the best solution then we do not believe that there should be any requirement to re-tender services every so many years. As previously discussed, we consider that tendering should only take place when the trustees are dissatisfied with the current fiduciary manager. Not mandating any specific period for retendering requires regular independent reporting, ideally annually, on the performance of the fund. This will alert trustees when there is an issue with the performance of the fund or any other aspect of the service and re-tendering can take place at that time.

Prohibiting investment consultants from providing fiduciary management to their advisory clients we consider is the most effective way of managing any conflict in this area.

There are however some potential related issues from this solution:

- It may result in a slower growth in fiduciary management. We believe that many consultants have recommended fiduciary management to their clients not only because of the potential governance benefits to trustees, but also because of the impact on their profitability. It is possible that investment consultants will be less keen to recommend fiduciary management to their clients if they cannot benefit. Theoretically, this should not happen, as the recommendation of a fiduciary management solution should have been given as their best advice and their best advice should not change just because they cannot profit from it! In reality, there will be less promotion of fiduciary management to existing clients. None-the-less, the concept of fiduciary management is now sufficiently established that we consider it will continue to grow.
- Actuaries have also been promoting their firm's fiduciary management services to their clients. Consideration should also be given to preventing the appointment of a fiduciary manager where a firm is the actuary since the issues of relationship and introducing their fiduciary management team ahead of a tender may apply.
- If investment consultants cannot offer their own fiduciary management services they may be tempted to go back to an implemented consulting model where premium fees can still be charged. This would fall under advisory consulting. The model we believe is inferior to fiduciary management for pension funds as there is less accountability and the benefits of fee savings from consolidation cannot be recognised.
- There are a large number of arrangements where the advisory consultant firm is providing partial fiduciary management to the client in existence. Consideration would be required as to what happens to these. Our belief is that they should be unwound over a period of three or five years with re-tendering of the partial fiduciary mandates.

Regulatory Framework and the Pensions Act 1995

Investment consultants and fiduciary managers would benefit from being within the regulatory perimeter of the FCA. This would not change market dynamics but would bring a degree of regulatory oversight to the sector that is currently lacking.

Furthermore, we consider section 36 of the Pensions Act 1995 is now out of date and needs amending. The Pensions Act 1995 was created at a time when the predominant method of investing pension scheme assets was by balanced pooled funds. It effectively created a high standard that trustees had to observe before investing their assets in a pooled fund. At that time, the balanced manager was responsible for both strategic asset allocation and stock selection. However, over the subsequent 20 years the roles of the investment consultant and fund manager has changed and fiduciary managers have appeared. The Pensions Act needs to be updated to reflect this.

Section 36 advice is only required for pooled funds and not for segregated funds. Typically, segregated funds are larger and potentially more impactful for pension funds than their pooled funds. It is absurd that investment of small amount of assets in a pooled tracker fund requires section 36 advice whilst, potentially, the investment of over 50% of the assets of a fund in a segregated LDI fund does not. The Pensions Act 1995 should be amended to include segregated funds.

In many respects a fiduciary manager is a more complex version of the old balanced manager. The fiduciary manager has responsibility for both strategic asset allocation and manager selection and, in some instances, stock selection but with a requirement to manage the assets against a more complex benchmark, the liabilities. Because of the structure of fiduciary managers, providing advice as well as asset management services they are not captured by the Pensions Act 1995. Extending the Pensions Act 1995 to cover fiduciary management and requiring Section 36 advice on the appointment of a fiduciary manager, would immediately, improve the selection process for fiduciary managers without the need to mandate that TPEs be involved.

A similar extension of the Pension Act 1995 to cover the selection of investment consultants should also be considered. As already noted, investment consultants now drive the key investment decisions of a pension fund not asset managers. Despite this, trustees would not consider appointing a fund manager without taking advice from their investment consultant but would select an investment consultant on minimal due diligence. This clearly undermines the governance of pension schemes and weakens the industry. As with fiduciary managers bringing the appointment of investment consultants under Section 36 would enhance governance across the industry with consequent benefits for members of pension schemes.

An extension of Section 36 advice to cover segregated fund, fiduciary managers and investment consultants would overnight improve governance of pension schemes. We can see no negative consequences of this change.

Appendix I:

TKU Indicative Syllabus 2009

December 2009

The Pensions Regulator

Trustee Knowledge and Understanding

The Foundation indicative syllabus

www.thepensionsregulator.gov.uk

Foundation indicative syllabus

Notes on the syllabus elements

As a guide to awarding bodies, skills councils and qualification standards regulators, the indicative syllabus has been drawn up using the language of the Pension Act 2004 to indicate levels of learning and assessment. This language also allows for the application of multiple choice assessments methodologies. The language used in the syllabus elements is in accordance with the following table:

Level	Category	Description
1	Knowledge (K)	Demonstrates a basic knowledge (or awareness) of the indicative content through the ability to recall information.
2	Understanding (U)	Demonstrates a sound knowledge and understanding (or working knowledge) of the indicative content through the ability to interpret, translate and extrapolate information, instructions and problems.

The requirements of the Act are such that the degree of knowledge and understanding demanded is spread unevenly across the units. Learning and assessment should be weighted across the syllabus in accordance with the following formula:

Law relating to trusts	20%	Unit 1 only
Law relating to pensions	20%	Unit 2 only
Funding and investment principles	30%	Units 3-9
Conversance	30%	Units 10-13

Foundation indicative syllabus

Unit 1: The law relating to trusts

This includes an understanding of the special nature of a pension trust and the duties, obligations and powers of trustees to operate pension schemes in accordance with the law and the trust documentation.

No	Scope stem items	Learning outcomes	Syllabus elements
1a	The definition and nature of a pension trust	Understand the definition and nature of a pension trust	Understand the definition and nature of a pension trust, including: • the concept of trust and that the trust is for the benefit of beneficiaries; • the purpose of the trust to provide pensions and other benefits in respect of members; • that legal ownership of assets rests with the trustee (not the sponsoring employer or individual members); • the separation between the scheme and the sponsoring employer, and the separation of assets; • the different types of beneficiary: - members (active, deferred, pensioner) - dependants and others - sponsoring employer (sometimes) • the purpose of the trust documentation (eg deed and rules, any amendments to rules, • Memorandum and Articles of Association (corporate trustees only)); • the obligation under trust law to take legal action where appropriate.
1b	Fiduciary duties	Understand the nature of fiduciary duties	Understand the nature of fiduciary duties, including: • the distinction between duties, powers and responsibilities; • the meaning of 'acting responsibly and prudently', including: - taking a considered view - justifying decisions and actions as required - taking all relevant factors into account - disregarding all irrelevant factors - reaching decisions that are reasonable • the obligation to safeguard the financial interests of all beneficiaries rather than a particular constituency, eg - in the choice of investment vehicles (DC) - in any decision involving the possibility of changing to a different pension arrangement, eg buying out or winding up the current scheme • the concept of duty of care and the standard to which it should be exercised; • the requirement to act impartially rather than identically between different classes of beneficiaries (including the sponsoring employer); • the duty not to profit from the trust; • the duty to see that sums owed are paid.

Continued over…

Unit 1: The law relating to trusts *continued*

1c	Professional advice and decision-making	Understand professional advice and decision-making	Understand the need for professional advice (where appropriate) before reaching decisions, including: • appropriate sources of advice and access to those sources; • the circumstances in which professional advice should be sought; • the circumstances and reasons for challenging professional advice; • the ultimate responsibility for making decisions.
1d	The role of advisers and suppliers to the scheme	Know the role of advisers and suppliers to the scheme	Know the role, responsibilities and accountabilities of advisers and suppliers to the scheme, including the employment by the trustees of (as appropriate): • actuaries • administrators • auditors • benefit consultants • custodians • financial advisers • fund managers • insurance brokers • investment consultants • investment managers • lawyers • providers Recognise that trustees remain accountable for all functions which they may delegate to others, except in the case of investment performance for fund managers.
1e	The particular role and use of advisers in special situations (DB only)	Know the particular role and use of advisers in special situations	Know that the changing circumstances of the sponsoring employer and the scheme involve different considerations upon which the trustees will need advice, eg actual or proposed corporate restructuring which threatens technical provisions or where the scheme or employer covenant is under threat. Requirements include: • the need to act and react promptly to changing circumstances and advice received; • the need to keep advisers fully up to date; • the possible need for different types of advice (eg investigative accountants for financial investigations of the company); • the need to reassess advisers in the light of possible conflicts of interest.
1f	Investment of scheme assets	Know about investing scheme assets	Understand the trustees' responsibility for investing scheme assets, including: • the overarching importance of acting in the 'best financial interests of beneficiaries'; • the provisions of the trust documentation; • the importance of the employer covenant (DB); • the definition of 'acting prudently'.

Continued over…

1g	The operation of the scheme in accordance with the trust documentation	Know about operating the scheme in accordance with the trust documentation	Know the trustees' responsibility for operating the scheme in accordance with the trust documentation, including the absolute requirement: • not to act other than strictly in accordance with the scheme rules; • only to amend the rules as permitted by the trust documentation and legislation; • to incorporate and act upon any amendments; • to follow any procedures set out in the Memorandum and Articles of Association • or equivalent documents (corporate trustees).
1h	Trustees' powers	Understand the trustees' powers	Understand the significance of the scheme's own trust documentation in relation to trustee powers including the power to: • amend the rules; • delegate functions while retaining responsibility; • authorise signatories for payments; • augment benefits (DB only); • set contributions (DB only); • exercise certain discretions (eg distribution of death benefits); • invest scheme assets; • wind up the scheme. Understand the limitations and conditions imposed by the trust deed and rules and relevant legislation. Understand the effect of legislation in: • adding powers to those found in the trust documentation; • altering or limiting powers found in the trust documentation; • requiring amendments to the trust documentation.
1i	The balance of powers between the sponsoring employer and the trustees	Understand the balance of powers between the sponsoring employer and the trustees	Understand: • the significance of the relative powers of sponsoring employer and trustees, particularly in making amendments to the scheme rules, setting contributions and agreeing recovery plans; • the importance of using such powers with restraint and the risks of the misuse of powers; • the implications of legislation which overrides the scheme rules in relation to powers, eg the requirement to consult the sponsoring employer, the role of the regulator in the event of a dispute, and the significance of the strength of the sponsoring employer covenant when negotiating.

Continued over…

1j	Conflicts of interest	Understand conflicts of interest	Understand the concept, nature and management of conflicts of interest, including: • situations which may give rise to conflicts, eg: - MNTs' personal constituencies - Trade Union interests - ENTs with sponsoring employer interests - trustees' personal interests - professional advisers acting for both sponsoring employer and scheme (esp DB) - investment advisers running a fund management service - trustees required to use their discretion in relation to members whom they know well (eg distribution of death benefits) • methods for managing conflicts (where appropriate), eg: - board policy for managing conflicts of interest - declaration in minutes - abstention from decision-making - taking independent advice • the particular potential for conflicts of interest in the event of corporate restructuring (DB only); • the importance of a written policy for identifying and managing conflicts of interest; • the implications of the balance of powers between the trustees and the sponsoring employer (DB only).
1k	Taking office	Know about taking office	When taking office know about: • the need for access to trust documentation; • the need for confidentiality; • the significance of conflicts of interest; • the requirement for signature mandates; • the implications of joint and several liability.
1l	Fitness and propriety to act as a trustee	Know the criteria for fitness and propriety to act as a trustee	Know the criteria for fitness and propriety which apply to trustees, including: • appreciation of the full range of trustee duties; • need for appropriate knowledge and understanding; • need for preparation for and regular attendance at meetings; • statutory and other disqualifications, including: - undischarged bankruptcy - conviction for fraud - mental ill health - absence abroad for more than 12 months - failure to attend meetings or to prepare adequately for them
1m	Ceasing to hold office	Know about ceasing to hold office	Know on ceasing to hold office: • the requirement to be taken off mandates; • that personal liability for past decisions remains.

Continued over…

Unit 1: The law relating to trusts *continued*

1n	Protections and immunities offered to trustees	Understand the protections and immunities offered to trustees	Understand the protections and immunities offered to trustees, including: • the importance of acting properly at all times; • the nature of the statutory protections under the Trustee Act; • the additional protections which may exist in the trust deed, in respect of: - exonerations - exemptions - indemnities • the loss of protections in cases of wilful default or fraud; • the limits of fines by the regulator; • the additional protection that may be obtained through insurance and the implications of trustee indemnity insurance.
1o	Trustees' responsibility for sound governance and administration	Understand the trustees' responsibility for sound governance and administration	Understand the trustees' responsibility for sound governance and administration, including: • secretariat functions, eg planning, minutes of meetings, correspondence, complaints; • administration functions, eg record-keeping, payment of benefits, receipt of contributions, checks for fraud; • risk management, eg internal controls, contingency planning; • decision-making and delegation. Systems and controls to be proportionate and include: • accurate record-keeping; • adequate assessment of scheme administration risks; • reconciliations of payroll, contributions and investments; • capture and maintenance of correct and up-to-date member data; • active co-operation with sponsoring employer over payroll data (esp DC) • accurate calculation and payment of benefits; • accurate recording of cash movements; • robust systems for contributions and unit allocations (DC only).

Unit 2: The law relating to pensions

This includes occupational pensions legislation (in outline) and the key provisions of related legislation that affects pension schemes and impacts on the role and activities of pension scheme trustees.

No	Scope stem items	Learning outcomes	Syllabus elements
2a	Occupational pensions legislation	Know the key provisions of occupational pensions legislation	Know the key provisions of occupational pensions legislation and regulations, including: • funding and contributions: - statements of funding principles (SFP) (DB) - actuarial valuations - schedule of contributions/payment schedules - recovery plans • Pension Protection Fund (PPF) guidance for ongoing schemes (DB only); • investment (including the requirement for a statement of investment principles (SIP) (as appropriate)); • disclosure to members; • transfers (including the different considerations for DB and DC); • regulatory matters, eg: - functions and powers of the regulator in relation to trustees - reporting to the regulator - notifying the regulator of notifiable events - whistle-blowing - codes of practice and guidance • awareness of proposals for future major legislative change already approved by the Government.
2b	The tax privileges and requirements for occupational pension schemes	Know the tax privileges and requirements for occupational pension schemes	Know, in principle, the provisions of the Finance Act 2004 and other tax requirements to the extent to which they affect schemes and benefits, including: • the conditions for being a Registered Pension Scheme; • the tax privileges enjoyed by Registered Pension Schemes; • the loss of tax privileges if the scheme fails to comply with the requirements; • the regime for allowing personal pensions and occupational pensions to run concurrently; • the cap on contributions (DC only) and benefits which attract tax privileges; • the requirement to deduct and pay tax from funds and benefits in payment.

Continued over…

Unit 2: The law relating to pensions *continued*

2c	Pensions related legislation	Know about pensions related legislation	Know the impact of other legislation on pension schemes and the provision of pensions benefits, including: • anti-discrimination legislation; • arrangements for giving advice on pensions; • civil partnerships legislation; • compensation arrangements; • data protection legislation; • employment legislation; • the Proceeds of Crime Act (2002) and other money laundering provisions; • parental leave; • the broad principles behind pensions sharing on divorce.
2d	The particular powers of the regulator in relation to sponsoring employers as well as trustees (DB only)	Know about the particular powers of the regulator in relation to sponsoring employers as well as trustees	Know about the particular powers of the regulator in relation to sponsoring employers as well as trustees, including: • financial support directions; • contribution notices; • clearance for corporate restructuring proposals and compromise agreements.
2e	Disputes resolution	Know the key aspects of disputes resolution	Know the key aspects of disputes resolution, including: • the nature of the Internal Disputes Resolution Procedure and time limits; • the importance of a written procedure; • the role of the Pensions Advisory Service; • the role of the Pensions Ombudsman; • the role of the Financial Ombudsman Service, recognising its limits in relation to occupational pensions.
2f	Member nominated trustees/directors	Know the key aspects of the member nominated trustee/director requirements	Know the key aspects of the member nominated trustee (MNT)/director (MND) requirements including, as appropriate: • nomination processes; • selection processes; • the proportion of board members who are MNTs/MNDs; • timescales; • full participation by MNTs and MNDs; • approval by sponsoring employer where appropriate; • removal of MNTs or MNDs; • the implications of being an MND and a member of a corporate entity for the purpose of running an occupational pension scheme.

Continued over…

Unit 2: The law relating to pensions *continued*

2g	The law relating to internal controls and sound administration	Know about the law relating to internal controls and sound administration	Know the legal requirements for adequate internal controls to ensure that the scheme is administered and managed in accordance with: • the scheme rules; • the requirements of the law; • the Data Protection Act; • the responsibility under common law to hold accurate and up-to-date member information. Know the legal and regulatory requirements in relation to the sound administration of schemes, including accurate records of: • contributions; • member data; • payments of pensions and benefits; • other payments made by or on behalf of the trustees.
2h	The interface between occupational schemes and state pension provision	Know about the interface between occupational schemes and state pension provision	Know the key aspects of state pension provision, including: • basic state pension; • pension credit; • additional state pension (state earnings related pension scheme (SERPS), state second pension (S2P)); • contracting out; • the relationship between means-tested benefits and pension scheme benefits.
2i	The obligation on employers to offer a qualifying scheme for all employees from 2012	Know about the obligation on employers to offer a qualifying scheme for all employees from 2012	Know about the obligation on employers to offer a qualifying scheme for all employees from 2012. Know about the proposed conditions for meeting the requirements for a qualifying scheme covering such matters as: • automatic enrolment of members; • minimum contribution rates; • eligibility for membership; • the definition of pensionable pay; • the powers of trustees to modify their scheme rules by resolution to meet the requirements for a qualifying scheme.

Unit 3: The basic principles relating to the investment of assets

This includes the major asset classes and their risk profiles as well as information about other assets classes and the principles of risk and reward.

No	Scope stem items	Learning outcomes	Syllabus elements
3a	Capital markets	Know about capital markets	Know in principle about: • the existence of economic cycles; • the possible effects of economic cycles on investment performance.
3b	The major asset classes and their characteristics	Understand the major asset classes and their characteristics	Understand the major asset classes and their characteristics, including: • equities • bonds • property • cash
3c	The implications of overseas investment	Know the implications of overseas investment	Know the implications of overseas investment, including: • foreign exchange risk; • political risk; • mitigating risks, eg by the use of currency hedging.
3d	The existence of other asset classes and investment techniques	Know about the existence of other asset classes and investment techniques	Know the existence of other asset classes and investment techniques, including: • packaged investment products; • alternative investments (such as hedge funds, private equity, active currency); • derivatives; • liability driven investment; • annuities used as an asset class; • default funds and lifestyling arrangements (DC); • with-profits arrangements (where appropriate); • market neutral arrangements for DC members.
3e	The balance between risk and reward	Understand the balance between risk and reward	Understand the following: • nature of risk; • the risk/reward profile of each major asset class. Know: • the basic principles of matching assets to liabilities (DB); • the basic principles of matching assets to pension expectations (DC); • the basic principles of managing risk by diversification of asset classes.

Unit 4: Funding – defined benefit (DB) occupational arrangements only

This includes the principles relating to the funding of DB occupational arrangements and the way in which the funding level is dependent upon the value of both the scheme's liabilities and its assets.

<table>
<tr><th>No</th><th>Scope stem items</th><th>Learning outcomes</th><th>Syllabus elements</th></tr>
<tr><td>4a</td><td>How the funding for DB occupational pension schemes works</td><td>Understand how the funding for DB occupational pension schemes works</td><td>Understand the principles underlying the funding of DB occupational pension schemes, including:

• the basic principles behind the calculations;
• the relationship between the value of the assets and the value of the liabilities;
• options in relation to funding benefits.</td></tr>
<tr><td>4b</td><td>How liabilities are valued for different purposes</td><td>Understand how liabilities are valued for different purposes</td><td>Understand how liabilities are valued for different purposes, including the effect on those valuations of:

• assumptions;
• the time horizons between now and when benefits have to be paid;
• future cash flows (contributions as inflows, benefit payments as outflows);
• actuarial methods for accounting for future salary increases in relation to past service and future service liabilities;
• the current and future size, age and gender profile of the membership;
• the current and future salary profile of the membership;
• the returns from each type of investment;
• the volatility of the value of liabilities:
- mortality rates
- inflation
- bond yields.</td></tr>
<tr><td>4c</td><td>How the market value of assets is assessed</td><td>Know how the market value of assets is assessed</td><td>Know how the market value of the major asset classes is assessed and the reasons for carrying out such valuations.</td></tr>
<tr><td>4d</td><td>Funding measures</td><td>Understand funding measures</td><td>Understand the different types of funding measure, including:

• liabilities in the event of discontinuing the scheme or buying out the benefits (solvency or buy-out);
• ongoing liabilities (including pensions already in payment);
• liabilities expressed for corporate accounting purposes for inclusion in financial statements (FRS17 and IAS19);
• liabilities in relation to both accrued (ie past) service and future service;
• technical provisions;
• the setting of contributions (eg recovery plans in the event of deficit).</td></tr>
</table>

Continued over…

Unit 4: Funding – defined benefit (DB) occupational arrangements only *continued*

4e	Potential risks to the ability of the scheme to pay benefits	Know about the potential risks to the ability of the scheme to pay benefits	Know that there are implications for the ability of the scheme to pay benefits in the event of increasing deficit or the financial instability of the sponsoring employer or corporate restructuring, including: • change of sponsoring employer; • merger or takeover; • management buy-out; • restructuring of sponsoring employer; • transferring liabilities to a new employer; • unusually high salary increases; • change in status within the group; • increased indebtedness; • poor performance or profit warnings; • request to reduce contributions/reluctance to increase contributions to meet an increased level of scheme deficit; • possible wind-up; • abandonment; • any sponsoring employer proposal for the buy-out of scheme liabilities; • volatility of assets relative to liabilities.
4f	The importance of complete, accurate and up-to-date data and calculations	Understand about the importance of complete, accurate and up-to-date data and calculations	Understand the need for complete and accurate data and the difficulties in achieving this without robust systems and processes. Trustees should understand the importance of (for example): • up-to-date records for every scheme member (including pensioner members); • reconciled membership lists eliminating duplications; • calculation routines complying with scheme rules and overriding legislation; • independent verification; • the impact of trustee decisions on the efficient administration of the scheme; • the effect of historical issues (eg data gaps, benefit entitlements).
4g	The impact of trustee powers	Know about the impact of trustee powers	Understand the process by which the exercising of trustee discretions (eg augmentation of benefits) can have an impact on the funding of the scheme.
4h	The nature and status of professional advice	Know the nature and status of professional advice	Know the nature and status of professional advice, including: • the basis upon which advice is given; • the implications if your adviser is also advising the sponsoring employer; • the nature of agreements between the trustees and adviser, and what they cover.

Continued over…

Unit 4: Funding – defined benefit (DB) occupational arrangements only *continued*

4i	Transfers and bulk transfers in and out of schemes	Know about transfers and bulk transfers in and out of schemes	Know the implications of transfers and bulk transfers in and out of schemes including the funding risks: • to members transferring out; • to members remaining in the scheme; • to members who may be offered inducements to transfer out by the sponsoring employer. Know: • what trustees should take into account when making those decisions; • how buy-ins work and the costs and benefits involved; • buy-outs and the implications of buying out members' benefits. Understand: • the responsibility of trustees to determine the assumptions used in calculation of CETVs; • the effect of any inducements offered by the employer; • the responsibility of trustees to achieve the best outcome possible for members.

Unit 5: Contributions: defined benefit (DB) occupational arrangements only

This includes the principles relating to the setting of contributions.

No	Scope stem items	Learning outcomes	Syllabus elements
5a	The nature of the employer/trustee relationship and the effect of the scheme's funding level on the sponsoring employer	Understand the nature of the employer/trustee relationship and the effect of the scheme's funding level on the sponsoring employer	Understand the nature of the employer/trustee relationship and the effect of the scheme's funding level on the sponsoring employer, in particular in the light of changes made in the Pensions Act 2004, including requirements for the trustees, irrespective of the scheme rules, to: • consult the sponsoring employer; • take responsibility for major decisions on contributions after taking professional advice. Trustees should further understand the effect on the sponsoring employer of the disclosure of any deficit in the sponsoring employer's annual accounts.
5b	The way in which the sponsoring employer covenant reflects its ability to fund the scheme	Know about the way in which the sponsoring employer covenant reflects its ability to fund the scheme	Know the importance of being aware of the sponsoring employer's business and its risk exposure including: • profitability; • factors likely to affect its future profitability; • other financial commitments (eg debt); • corporate structure. Know the usefulness of various sources of information which will allow trustees to monitor the employer covenant, including: • sponsoring employer's audited accounts and auditor's report; • any profit warnings; • comments in the financial and trade press; • publicly available analysts' reports on sponsoring employer (where they exist); • sponsoring employer's credit ratings; • capital market information (eg credit spreads); • trustee-appointed financial expert's report on sponsoring employer.
5c	The calculation of regular contributions to fund liabilities for future accruals	Understand the calculation of regular contributions to fund liabilities for future accruals	Understand the mechanism for calculating regular sponsoring employer contributions to fund future accruals taking into account such matters as: • the proportion of active members; • the age profile of active members; • the maturity of the scheme.

Continued over…

Unit 5: Contributions: defined benefit (DB) occupational arrangements only *continued*

5d	The setting of special contributions for past service as required	Understand the setting of special contributions for past service as required	Understand the principles for setting special contributions for past service in the event of deficit, especially where there is disagreement between trustees and the sponsoring employer on the size of the special contribution required, including: • the assessment of the range of options recommended by the actuary/actuaries; • the importance of the relevant powers of trustees and sponsoring employers; • the importance of affordability and the requirement to reach agreement; • processes for resolving the problem; • recovery plans; • notifying the regulator.
5e	Member contributions	Know about member contributions	Know the implications of pension funding by members including (where appropriate): • regular contributions; • additional voluntary contributions (AVCs) and added years arrangements; • free standing additional voluntary contributions (FSAVCs); • salary/bonus sacrifice; • concurrent personal pension/stakeholder arrangements; • timeliness of payments to the scheme; • the importance of complete, accurate and up-to-date member records; • the importance of robust systems and processes.
5f	The role of the sponsoring employer in the calculation and collection of member contributions	Know about the role of the sponsoring employer in the calculation and collection of member contributions	Understand the reliance of the scheme on the sponsoring employer for: • the correct calculation, deduction and timely payment of the correct contributions; • access to the relevant parts of the sponsoring employer (eg payroll, HR, IT and treasury); • meeting its legal responsibilities in respect of all these matters.

Unit 6: Strategic asset allocation: defined benefit (DB) occupational arrangements only

This includes the principles relating to the suitability of different asset classes to meet the liabilities of the scheme, taking account of the strength of the employer covenant and the trustees' risk profile for the scheme.

No	Scope stem items	Learning outcomes	Syllabus elements
6a	The process of strategic asset allocation	Understand the process of strategic asset allocation	Understand the process of strategic asset allocation, including the importance of seeking an appropriate mix of asset classes, taking into account: • diversification of asset classes; • correlation between asset classes; • matching liabilities with assets; • the trustees' investment objectives; • the risk appetite and/or risk budget of the sponsoring employer and of the trustees; • the balance of powers between the trustee board and the sponsoring employer; • the strength of the sponsoring employer covenant; • the implications for the company balance sheet.
6b	The characteristics of alternative asset classes and financial instruments	Understand the characteristics of alternative asset classes and financial instruments	Understand the characteristics of alternative asset classes and financial instruments: • alternative investments (such as hedge funds, private equity, active currency); • derivatives; • the correlation between investment returns of different asset classes.
6c	The use of specialised investment techniques	Understand the use of specialised investment techniques	Understand the use of specialised investment techniques, in particular liability driven investment arrangements including: • interest rate and inflation swaps; • longevity insurance/swaps; • tailored bond portfolios.
6d	Reviewing asset allocation decisions	Know about reviewing asset allocation decisions	Know the ways in which asset allocation decisions may need to be amended where there is a change in maturity or status of the scheme, including: • current contributions no longer sufficient for benefit payments; • closure to new members; • closure for future service. Understand the importance of the decision-making, implementation and review processes.

Unit 7: Running a defined contribution (DC) occupational arrangement (including AVCs)

This includes the principles relating to the operation of DC occupational arrangements and the risks borne by scheme members.

No	Scope stem items	Learning outcomes	Syllabus elements

7a	How DC occupational pension arrangements work	Know how DC occupational pension arrangements work	Know how DC occupational pension arrangements work, including:
			
			• accumulating a fund to secure benefits on retirement;
			• the various options for securing benefits at retirement (decumulation), eg:
			  - open market annuity options
			  - income drawdown
			  - unsecured pension arrangements
			  - alternatively secured pension arrangements
			• the payment of fees, charges and expenses;
			• the operation of a trustee bank account;
			• the interpretation of statutory and other defined contribution illustrations;
			• protected rights (where applicable).

7b	Administration procedures specific to DC occupational arrangements	Understand the administration procedures specific to DC occupational arrangements	Understand the responsibilities of trustees in relation to effective administration, including: • the significance of effective administration arrangements; • the importance of complete, accurate and up-to-date member records; • the importance of accurate and timely collection of contributions and allocation of assets; • the risks and implications for members of failures in administration arrangements; • the cost and other implications of having to unwind administrative errors (eg incorrect investments, charges, or allocation of assets) and reprocessing these correctly; • regular reconciliations; • the accurate and timely switching of assets when required (eg lifestyling); • the importance of robust systems and processes.
7c	The role of the employer in the calculation and collection of member contributions	Understand the role of the employer in the calculation and collection of member contributions	Understand the difference in the particular responsibilities of the sponsoring employer and the trustees in the calculation and collection of member contributions in DC arrangements, including: • the sponsoring employer's responsibility to deduct the correct member contributions; • the sponsoring employer's responsibility to deal with joiners and leavers correctly; • the sponsoring employer's responsibility to make the correct sponsoring employer contribution; • the joint responsibility to set as simple a contribution structure as possible; • the trustees' responsibility for collecting the correct contributions for each member.

Continued over…

7d	The implications of the transfer of risk to members of DC occupational arrangements	Understand the implications of the transfer of risk to members of DC occupational arrangements	Understand the implications for members of the risks they carry, including: • market risk; • mortality risk; • changes to the legislation or tax regime; • contributions not being paid across to the scheme accurately and on time; • excessive charges and up front charging structures; • ineffective communications between members and trustees; • lack of member understanding of pension funding in general; • insufficient contribution levels; • inappropriate investment choices by members; • inappropriate or uninformed decision-making at retirement.
7e	The implications of contracting out	Know the implications of contracting out	Know the significance of the SERPS/S2P guarantee and the implications of a Guaranteed Minimum Pension (GMP), where applicable. Know about the legislation enabling GMPs to be converted into normal scheme benefits.

Unit 8: Investment choices and the implications for members: defined contribution (DC) occupational arrangements (including AVCs)

This includes the principles relating to the choice of investments to be offered to members.

No	Scope stem items	Learning outcomes	Syllabus elements
8a	The implications for members of the investment strategy adopted by trustees	Understand the implications for members of the investment strategy adopted by trustees	Understand the implications for members of the investment strategy adopted by trustees, including the following factors: • whether or not trustees offer investment choices to members; • levels of contribution; • age of the members and their proximity to expected retirement; • access to advice and the nature of the advice available; • number and range of investment options; • appropriateness of investment offerings given the profile of the membership; • availability of tracker funds; • arrangements for switching between funds and associated charges; • the role of default or lifestyle options; • provision of education and information to members; • charges and the implications of charging structures for fund growth.

8b	The importance of member understanding of investment risk	Understand the importance of member understanding of investment risk	Understand the extent to which members need to know about investment risk, including:
			• asset classes
			  - equities
			  - bonds
			  - cash
			  - property
			  - insurance policies (including 'with-profits' where applicable)
			• the nature of risk and the risk/reward profile of each asset class;
			• the concept of a member's own risk appetite;
			• charges and their impact on fund growth;
			• the implications of a failure to take these matters into account;
			• the implications of trustee rather than member decision-making on investments.

Unit 9: Fund management

This includes the principles of fund management and how the performance of fund managers can be measured.

No	Scope stem items	Learning outcomes	Syllabus elements
9a	The structure of investment portfolios	Understand the structure of investment portfolios	Understand the structure of investment portfolios including: • actively managed versus passively managed (tracker) funds; • pooled funds versus segregated portfolios of individual shareholdings; • the combination of passive and active management (eg the use of core/satellite arrangements); • the implications for cost, liquidity and governance of each major investment decision; • the extent to which asset allocation is delegated to the fund manager (eg tactical asset allocation); • the importance of rebalancing a portfolio, especially where there are two or more fund managers; • investment style (eg value or growth).
9b	The selection of fund managers	Understand the selection of fund managers	Understand how to conduct the selection of a fund manager, including: • the appointment and role of advisers; • long listing, short listing and the 'beauty parade'; • the importance of investment style (value, growth or an amalgam of these) as outlined in the SIP; • agreement on benchmarks and targets; • the costs of fund management and the costs of transition; • investment management agreements; • managing the transition in the event of a change in fund management; • the importance of internal controls in the event of a transition.
9c	Investment mandates	Understand investment mandates	Understand the mandates given to all advisers and managers and any other individuals to whom investment functions have been delegated, including: • the nature of the contract between the trustees and their advisers; • the role of performance measurement and targets; • fee structures and charges.
9d	Measurement of performance using indices, benchmarks and targets	Understand measurements of performance using indices, benchmarks and targets	Understand the use of indices, benchmarks and targets to measure performance, including: • the implications of index selection to reflect alternative asset classes; • the construction of a suitable benchmark to reflect the investment requirements of the trustees; • the implications for fund managers of having to meet a benchmark; • the significance of having realistic targets; • limitations of indices and peer group comparisons.

Continued over…

9e	The mechanisms for monitoring investment arrangements and fund managers	Understand the mechanisms for monitoring investment arrangements and fund managers	Understand the mechanisms for monitoring investment arrangements and fund managers, including: • reports from fund managers, including: • diagrams and graphs illustrating performance • the significance of timescales in reporting performance • the way charges are accounted for • the quarterly record of corporate governance decisions • changes within the fund manager organisation; • compliance with the statement of investment principles (SIP); • the completeness and accuracy of records (DB and DC) and of calculations (DC only); • the calculation and impact of charges and fees; • management of any transition of assets between investment managers or asset classes; • robust processes and systems; • calculation and apportionment of investment returns.
9f	The importance of sound custody arrangements	Know the importance of sound custody arrangements	Know the usual custody arrangements and the importance of independent guardianship of scheme assets, including: • issues to consider when selecting a custodian: • scheme specific requirements • the importance of a clear and structured selection process • transparency of fees and the place of benchmarking • legal advice on key provisions in custody agreements • agreed service standards and reporting requirements • incorporation of any operational issues, eg practice in recovering tax • level and frequency of relationship reporting • issues arising on transfer to new custodian, eg secure transition of assets; • the need for adequate monitoring and correct record-keeping.
9g	The importance of responsible ownership of assets	Understand the importance of responsible ownership of assets	Understand the importance of responsible ownership of assets, including: • the extent to which social, environmental and ethical considerations are taken into account when making investment decisions; • the corporate governance of the companies in which the trustees invest; • the extent to which (if at all) they will exercise their voting rights.
9h	The Myners principles for the governance of the investment decision-making process	Understand the Myners principles for the governance of the investment decision-making process	Understand the Myners principles for the governance of the investment decision-making process.

Unit 10: A working knowledge of the scheme's own trust documentation

This includes any subsequent amending documents.

No	Scope stem items	Learning outcomes	Syllabus elements
10a	The duties, powers and discretions of trustees	Know the duties, powers and discretions of trustees	Know the duties, powers and discretions of trustees under their own trust deed, scheme rules and amendments including, as appropriate: • setting contributions; • amending the trust deed and scheme rules; • augmentation of benefits; • power of delegation; • power to terminate the scheme; • power to wind up the scheme; • transfers; • investment; • changes in power in response to specific events.
10b	The balance of powers between the sponsoring employer and trustees	Know the balance of powers between the sponsoring employer and trustees	Know the balance of powers between sponsoring employer and trustee including: For DB only: • the significance of the relative powers of sponsoring employer and trustees, particularly in making amendments to the scheme rules, setting contributions and agreeing recovery plans; • the importance of using such powers with restraint and the risks of the misuse of powers; • when to use which powers, especially when the scheme or sponsoring employer is under threat; • the implications of legislation which overrides the scheme rules in relation to powers, eg the requirement to consult the sponsoring employer; • the strength of the sponsoring employer covenant when negotiating. For DC only: • the size of contributions; • investment decisions; • the calculation of contributions.
10c	Categories of membership in the scheme	Know the categories of membership in the scheme	Know the categories of membership in the scheme including, for each category: • eligibility for membership; • benefit structures (DB); • any guarantees (eg bulk transfers in, pre-1997 and post-1997); • specific arrangements for pension increases; • contribution rates (DC); • retirement ages.

Continued over…

Unit 10: A working knowledge of the scheme's own trust documentation *continued*

10d	Benefits offered (DB only)	Know the benefits offered	Know the benefits offered, how they are calculated, the circumstances in which they are payable (both current and historic) and how the payments are made, including: • pensions; • lump sums (eg on retirement or winding up); • early retirement; • ill health early retirement; • refunds of contributions; • transfers; • eligibility for death in service lump sum; • arrangements for spouses, dependants and civil partners; • divorce/dissolution of civil partnerships. Recognise that the details may vary from one category of member to another and from one tranche of past service to another.
10e	Decumulation of pension funds (DC only)	Know how pension funds can be converted into pension benefits (decumulation)	Know the default arrangements for converting accumulated funds into pension benefits (decumulation) and how alternative arrangements are offered, including: • open market annuity options; • income drawdown; • unsecured pension arrangements; • alternatively secured pension arrangements.

Unit 11: A working knowledge of the scheme's Statement of Investment Principles (SIP)

No	Scope stem items	Learning outcomes	Syllabus elements
11a	Roles and responsibilities for preparing the SIP	Understand the roles and responsibilities for preparing the SIP	Understand the respective roles and responsibilities of trustees, scheme actuary, investment consultant, fund manager and sponsoring employer when preparing the SIP.
11b	The scheme's investment objectives and asset allocation strategy	Understand the scheme's investment objectives and asset allocation strategy	Understand the scheme's investment objectives and the views of the sponsoring employer. Understand the scheme's planned asset allocation strategy and its appropriateness to its liabilities and to the trustees' appetite for risk, including: • target investment returns on each asset class; • how the strategy has been arrived at; • volatility considerations; • risk mitigation.
11c	The contents of the SIP	Understand the contents of the SIP	Understand the legal, regulatory and other requirements for the information that must be included in the SIP, eg: • investment objectives; • managing investment risk; • the implications of charges; • the place of active and passive management; • the nature and purpose of mandates; • the limitations on investment imposed by the SIP (if applicable); • the implications of transaction costs (including soft commissions) and their disclosure; • the trustees' attitude to corporate governance and socially responsible investment issues and how these are managed.
11d	Monitoring and updating the SIP as appropriate	Understand the need for monitoring and updating the SIP as appropriate	Understand the need for regular and frequent review and those matters which might prompt interim revisions of the SIP, including: • any change in investment arrangements for the scheme; • marked change in investment environment; • change in the status of the scheme, eg closure to new members; • any change in the sponsoring employer covenant.

Unit 12: A working knowledge of the scheme's Statement of Funding Principles (SFP) (DB schemes only)

No	Scope stem items	Learning outcomes	Syllabus elements
12a	Roles and responsibilities for preparing the SFP	Understand the roles and responsibilities for preparing the SFP	Understand the respective roles and responsibilities of trustees, sponsoring employer and scheme actuary when preparing the SFP.
12b	The scheme's statutory funding objective	Understand the scheme's statutory funding objective	Understand the scheme's statutory funding objective and the policy for meeting that objective, including: • the actuarial method and assumptions used to calculate the scheme's technical provisions; • the risks associated with the statutory funding objective; • how any failure to meet the statutory funding objective is to be addressed.
12c	Contents of the SFP	Understand the contents of the SFP	Understand the nature of the information that must be included in the SFP and the matters which must be agreed with the sponsoring employer, including: • funding objectives in addition to the statutory funding objective; • technical provisions including methodology and assumptions; • discount interest rates; • pension increases; • pay increases; • mortality; • new entrants; • leaving service; • retirement; • age difference of dependants; • percentage with dependants' benefits at death; • expenses; • policy on discretionary increases and funding strategy; • recovery period for schemes in deficit; • policy on cash equivalent transfer values; • payments to the sponsoring employer if any; • frequency of valuations.
12d	Monitoring the SFP	Understand the need for monitoring the SFP	Understand the need for regular monitoring and the implications of any change of status in the scheme which might prompt a revision of the SFP, including: • a closure to new members or to future service; • corporate restructuring; • a change to the sponsoring employer covenant; • any proposal to wind up the scheme.

Unit 13: A working knowledge of the scheme's other relevant documents

These include:

No	Scope stem items	Learning outcomes	Syllabus elements
13a	Scheme booklet, announcements and other member communications	Know the principal contents of the scheme booklet, announcements and other member communications	Know the principal contents of the scheme booklet, announcements and other member communications, including the members' popular report and accounts.
13b	Principal contents of the most recent actuarial valuation and subsequent actuarial advice (DB only)	Know the principal contents of the actuarial valuation and advice	Know the principal contents of the most recent actuarial valuation and subsequent actuarial advice, including: • the recommendations in the valuation and the reasons for accepting them; • details of any recovery plan (if appropriate); • the summary funding statement.
13c	Minutes of meetings	Know about the value of the minutes of meetings	Know the role and value of the minutes of meetings for the governance of the scheme, including: • their importance; • policy discussions and decisions recorded in them.
13d	Regular stewardship reports	Know about stewardship reports	Know the purpose and content of stewardship reports, including: • the importance of receiving an appropriate report; • the need to: - analyse and question the contents - identify the key issues - anticipate the implications for the immediate or longer term - cover any compliance issues and breaches.
13e	Schedule of contributions (DB) and any payment schedule (DC)	Know about the schedule of contributions (DB) and any payment schedule (DC)	Know about the schedule of contributions (DB) and any payment schedule (DC) and how to check them for accuracy.
13f	Internal audit reports or reports of alternative internal checks	Know about internal audit reports or reports of alternative internal checks, eg internal controls report	Understand nature of the document and the limitations of the information provided, as well as the importance of: • checks on the adequacy and robustness of systems; • accuracy in the calculations included in member communications; • an action plan to rectify any issues identified; • the place of the action plan in the scheme's business plan; • the cost implications of exercises of this nature; • risk management and the maintenance of a risk register.

Continued over…

Unit 13: A working knowledge of the scheme's other relevant documents *continued*

13g	Annual report and accounts for the scheme and for the sponsoring employer	Know the principal contents of the annual report and accounts for the scheme and for the sponsoring employer	Know the principal contents of the annual report and accounts or audited statement of contributions for the scheme and for the sponsoring employer.
			
			For schemes, this will include:
			
			• financial statements:
			  - cash flows (income and payments)
			  - balance sheet
			• reports from fund managers;
			• compliance statement;
			• actuarial statement and certificate;
			• trustees' attendance at meetings.
			
			For the sponsoring employer it will include:
			
			• any scheme deficit in the balance sheet (DB only);
			• financial statements and implications for the financial viability of the organisation.

13h	Any significant contract in respect of scheme assets	Know the principal terms of any significant contract in respect of scheme assets	Know the principal terms of any significant contract in respect of scheme assets, including: • contingent assets and guarantees; • in outline, the terms of any insurance policies and their consistency with the trust documentation.
13i	Any other significant agreement or contract	Know the principal terms of any other significant agreement or contract	Know the principal terms of any significant agreement or contract with those given delegated authority, professional advisers or suppliers, including: • delegated authorities; • letters of appointment with professional advisers or suppliers; • service level agreements; • any subcontracting of activities.
13j	Any trustee approved procedures	Know the principal contents of any trustee approved procedures	Know the principal contents of any trustee approved procedures, including documentation related to: • the internal disputes resolution procedure (IDRP); • arrangements for appointing all groups of trustees and the chair; • policy to manage conflicts of interest; • review of the risk register.
13k	Statement of compliance with the Myners principles (where appropriate)	Know the contents of the statement of compliance with the Myners principles (where appropriate)	Know the contents of the scheme's statement of compliance with the Myners principles where appropriate.
13l	Terms of reference of any sub-committee (where relevant)	Know the terms of reference of any sub-committee (where relevant)	Know the terms of reference of any sub-committee and the procedures for ratification.

Continued over…

13m	Memorandum and Articles of Association of corporate trustee (where applicable)	Know the principal contents of the Memorandum and Articles of Association of the corporate trustee (where applicable)	Know: • the principal contents of the Memorandum and Articles of Association (or equivalent documents) of the corporate trustee; • how these reflect the trust documentation; • how these affect the activities of the trustees (eg requirements for a quorum).
13n	The scheme's business plan	Know the principal elements and features of the scheme's business plan	Know the principal elements and features of the scheme's business plan allowing for: • an actively managed timetable of upcoming events and meetings; • timetabled review of the expenses budget and cash flow forecast; • risk assessment and follow up; • scheduled and ad hoc projects (eg valuations, annual report and accounts, existence testing); • trustee learning activities; • sponsoring employer's meetings and decisions.
13o	Job descriptions for the chair and for the trustees	Know the important components of the job descriptions for the chair and for other trustees	Know the important components of the job descriptions for the chair and for other trustees, including: *For the chair*: • ensuring sufficient meetings to manage the business of the scheme; • approving the papers for the meeting in good time for distribution to the other trustees in good time; • taking steps to ensure meetings are properly recorded; • ensuring the trustees have appropriate advice and sufficient information to fulfil their role properly; • arranging for the induction of new trustees; • helping trustees evaluate their performance; • monitoring the work of sub-committees; • carrying out any tasks delegated by the board (eg negotiation with the sponsoring employer – DB schemes only); *For the other trustees:* • preparing and attending meetings; • keeping up to date with deed and rules; • ensuring they are satisfied with scheme's internal controls and administration; • completing all necessary learning; • participating fully in board discussions.

Continued over…

Unit 13: A working knowledge of the scheme's other relevant documents *continued*

13p	Trustee skills audit, training needs analysis and training log	Understand the importance of a trustee skills audit, training needs analysis and training log	Understand the relationship between the learning carried out by a board of trustees and improvements in scheme governance. This would be evidenced by: • changes over time in the skills audit; • changes over time in the training needs analysis; • training log; • certificates of any relevant learning completed; • any relevant voluntary qualifications obtained; • minutes of trustee meetings.
13q	The whereabouts of all original documents and the arrangements for their custody, safekeeping and access	Know the whereabouts of all original documents and the arrangements for their custody, safekeeping and access	Know where all scheme documents are kept and the arrangements for their custody, safekeeping and access.

Appendix II

Blacket Research

Fund Manager Selection Report 2006

Fund Manager Selection Survey Report 2006

PART 1 - GENERAL OVERVIEW

blacket research limited

Contents

Section 1 : Executive Summary

This research is based on information collected from a survey of pension schemes carried out between February and April 2006. This resulted in information on 247 fund manager selection processes being submitted by 80 pension schemes. The survey looked at the manager selection process for new managers appointed since 1999 for a variety of asset classes. Details of the mandate, the selection process, the perception of the quality of advice and both the shortlist and final selection were collected.

To measure the performance of segregated fund selections the appropriate Global Investment Performance Standard (GIPS) composite or AIMR-PPS performance records for each fund manager were used. When assessing the effectiveness of pooled mandates the Mellon Analytics pooled fund universe performance data was used.

GIPS composite data is calculated for equity, bond, property and multi-asset mandates. Analysis of the effectiveness of short lists is limited to those products. There are 127 selection processes which fall within these categories, 87 of which were completed in 2004 or earlier.

Performance

20% of mandates analysed outperformed against the objective net of fees since inception and 80% have underperformed.

Decision Making at Pension Schemes

Over 70% of the final selection decisions were taken by the trustee board and 23% by the investment committee. At a small minority of schemes the final decision was taken by the pension's manager or finance director.

Perception of Advice

70% of pension schemes felt the overall value they received from their investment consultants was good or very good, 23% rated the overall value as average and 5% as poor or very poor.

82% of pension schemes rated the quality of advice as good or very good, 13% as average and 3% as poor.

Over 40% of those pension schemes that rated the quality of advice as good or very good have fund managers that are not achieving their objective. 38% of those that rated the quality of advice as poor have fund managers that are outperforming the objective.

Influence of past performance

Past performance plays a significant role in consultant's manager recommendations for equity mandates. 48% of recommendations were top quartile and 32% were second quartile over the previous five years.

The majority of bond and property recommendations were in the second and third quartile based on the previous five years performance.

There was no clear bias in the final selection by pension schemes toward managers with stronger past performance records.

Concentration

The level of concentration in manager recommendations was high. Ten fund managers have enjoyed 50% of all equity mandate recommendations over the last five years while 80% of recommendations have been shared by just 30 managers.

Consultant Effectiveness

Four measures have been used to assess the consultant's value added in recommending fund managers that outperform. The results from these imply that consultants are able to identify skilful fund managers but that in the short term the evidence for this is less clear. The findings are in line with the work of Goyal & Wahal in the US who found that manager selections involving consultants improved post hiring results.

Shortlists for equity and property mandate selections generally provide more value added than those for bond mandates.

The opportunity for consultants to add value in identifying managers with appropriate risk controls was limited by the successful risk control at most equity fund managers. Consultants found the recommendation of managers able to manage their portfolios within the risk constraints more problematic for bonds than equities.

Where the consultant shortlist recommendation was positive, the probability of selecting an outperforming manager was almost 20% higher than if the advice was poor.

Trustees Decision

58% of final decisions selected one of the poorer performing managers from a shortlist and 42% selected one of the better performing managers. Positive selection decisions resulted in the probability of selecting an outperforming manager increasing by almost 25%.

Investment Committees

The benefits of delegating manager selection decisions to investment committees appear substantial. 67% of selections taken by investment committees selected one of the better performing managers from the shortlist compared to only 25% of decisions taken by trustee boards.

Impact of Scheme Size

There is no evidence from our sample that large schemes (i.e. those over £1 billion) are more successful at selecting fund managers than smaller schemes. This result was insensitive to different thresholds for the classification between large and small schemes and was not changed by considering performance against the benchmark rather than the performance objective.

The quality of advice provided by consultants to large schemes (i.e. those over £1 billion) is not significantly different to advice provided to smaller schemes.

Large schemes do appear to have an advantage in their decision making when choosing fund managers. 47% of selections by large schemes were positive compared to 37% for smaller schemes.

Consultant Effectiveness and Trustees' Decision Combined

The combination of positive advice and a positive decision by trustees in selecting the fund manager from the shortlist results in a 57% probability of choosing a manager that outperforms the objective. This compares with an 8% chance of selecting an outperforming manager where both the advice and selection are poor.

If performance against the benchmark is considered, then the combination of positive advice and a positive selection decision results in 86% of selections outperforming. On the other hand, 85% of selections underperform the benchmark if both the advice and selection are negative.

The benefits to pension schemes from seeking to understand and improve their decision making processes are clearly substantial.

Throughout the report we refer to outperformance or underperformance against the objective or benchmark and the success or otherwise of a mandate. These comments generally relate to the performance of the managers GIPS composite for the appropriate product. Where the comments relate to specific information received from pension schemes on the performance of their mandate this is noted in the text. In presenting the results in this way we nonetheless recognise that mandate success depends on a wider consideration of factors than is covered in this report.

Section 2 : Introduction

Pension schemes invest substantial resources in the selection and monitoring of fund managers with little or no feedback on the added value they get from this investment. This issue was first highlighted in the Myners Report which stressed the value that could be added to pension schemes by effective measurement and monitoring of the consultants advice and the trustee decisions. The review of progress on the Myners Report published by The Treasury in December 2004 showed that little improvement had been made in this area since the publication of the original report. One of the main reasons for the lack of progress was described in a report published by Instinet entitled 'Taking the Temperature of the UK Pension Fund Industry' which stated:

"pension schemes continue to struggle to find accurate methods of measuring the advice they receive from consultants because of a lack of a common industry consensus and approach".

As a result, pension schemes lack feedback on areas of strength and weakness in their manager selection process and consequently cannot amend this process to improve its effectiveness.

Pension schemes lack feedback on areas of strength and weakness in their manager selection process and consequently cannot amend this process to improve its effectiveness.

When seeking to change a fund manager, pension schemes will often follow the same selection process that resulted in selecting the now fired, previous manager. They behave on the assumption that there is no relationship between the selection process and the outcome in terms of the performance of the appointed fund manager. This assumption could be costing pension schemes significant returns.

There have so far been few studies of the manager selection process. Those that have been done have focused on the performance of the appointed and fired fund managers in the period before and after appointment. The first work completed in this area in the UK was carried out by The WM Company back in 1996. This has since been regularly updated with the most recent version published in 2005. The results of these reports whilst varying in detail remain the same in their broad conclusion. Managers tend to be fired after periods of poor relative performance and replaced by managers with strong track records who subsequently disappoint. Within two years following the change the new manager's performance was found to have typically fallen behind the fired manager's performance.

In the US, a study in 2005 by Amit Goyal & Sunhil Wahal of the Goizueta Business School looked at a large sample of hiring and firing decisions. They again observed that good past performance was a key factor in the hiring decision but that overall, after hiring the managers, performance was statistically no different to zero. Within these results they also observed that;

- the stronger the pre-hiring performance the weaker the post-hiring performance
- large schemes enjoyed better post-hiring returns than small schemes, evidence of greater skill at large schemes
- involving consultants in the selection process improved post-hiring returns.

Section Two

We focus on the decision-making process for selecting fund managers to identify those elements of the process that are adding value.

In this report, we focus on the decision-making process for selecting fund managers to identify those elements of the process that are adding value and where weaknesses may exist. The report is based on a survey of fund manager selection processes carried out by pension schemes since 1999. This provides information on the success of the manager selection and the perception pension schemes have of the quality of advice they receive from their investment consultants. Several statistical methods to measure the quality of consultants' advice are introduced. These methods, which can be applied consistently across equity, bond and property mandates, are used to establish how effective consultants are in providing manager selection advice to pension schemes. A framework for measuring the trustees' decision is described and then used to identify the effectiveness of trustee and investment committee decisions highlighting areas of best practice.

Section 3 : Research Data

3.1 Pensions Survey

The survey looked at the manager selection process for new managers appointed since 1999 for a variety of asset classes.

This research was based on information collected from a survey of pension schemes carried out between February and April 2006. This resulted in information on 247 fund manager selection processes being submitted by 80 pension schemes. The survey looked at the manager selection process for new managers appointed since 1999 for a variety of asset classes. Details of the mandate, the selection process, the perception of the quality of advice and both the shortlist and final selection were collected.

3.2 Manager Selection Data Overview

Data from both corporate and local authority pension schemes ranging in size from £5 million to over £10 billion was collected.

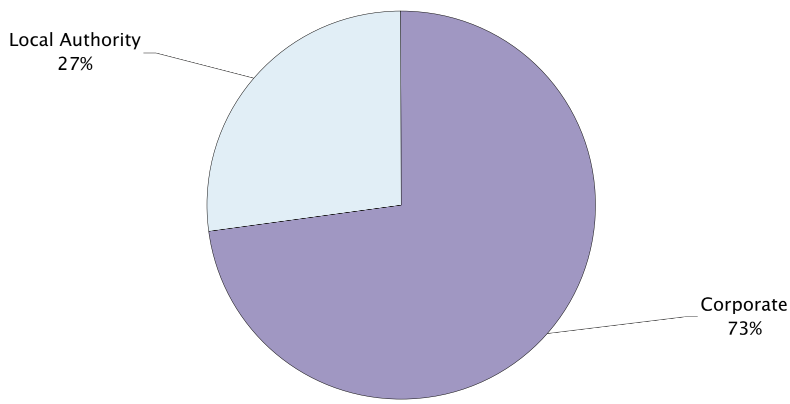


Chart 3.2.1: Breakdown of the schemes by type

For parts of the analysis, the schemes have been divided into large and small schemes. The cut off point has been set at £1 billion. 31% of respondents were large schemes and 69% were small schemes.

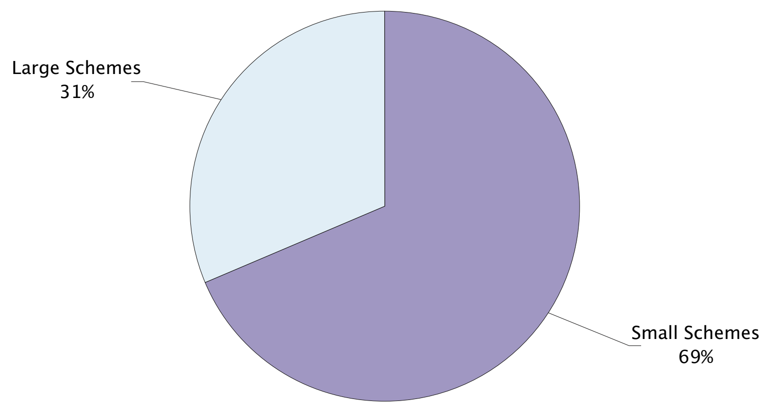


Chart 3.2.2: Breakdown of schemes by size

Large schemes typically employ a greater number of managers than smaller schemes and consequently carry out more manager selections. Of the 247 fund manager selection processes analysed 51% were carried out by large schemes and 49% by small schemes.

Section Three

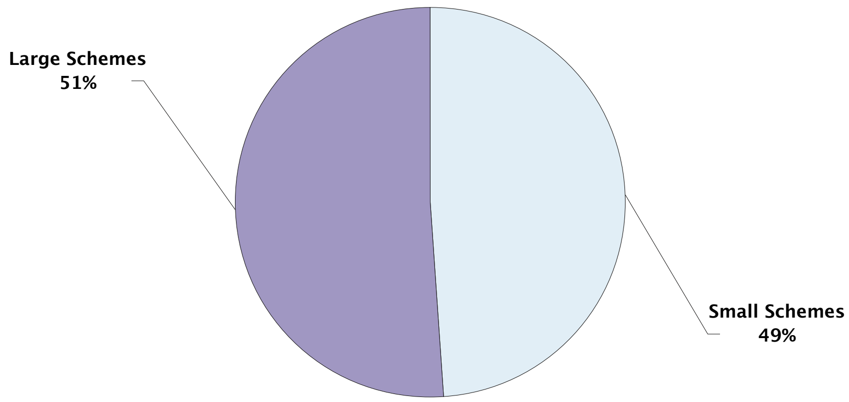


Chart 3.2.3: Breakdown of mandates by scheme size

Almost two thirds of the selection data collected related to segregated mandates or schemes where a majority of the assets were run on a segregated basis.

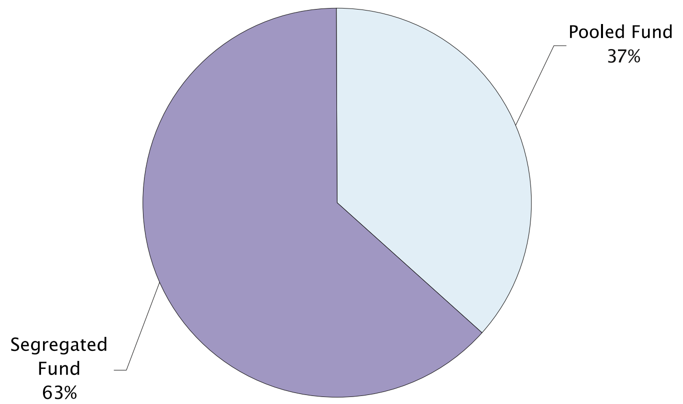


Chart 3.2.4: Breakdown of schemes by mandate type

The majority of mandates in the survey were equity mandates reflecting the greater proportion of assets invested in equities at most pension schemes. As would be expected, a proportion of the mandates, particularly in more recent years, related to the newer types of mandate such as hedge funds and private equity.

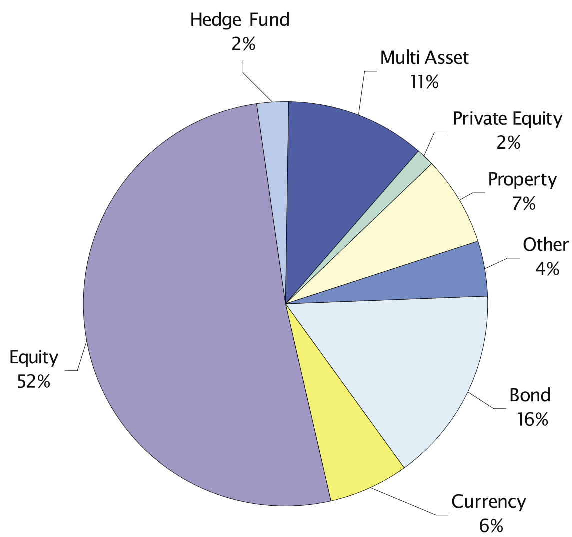


Chart 3.2.5: Breakdown of mandates by product type

Almost 90% of the selection information received related to active mandates. While passive mandates are generally for a larger proportion of the assets, most schemes have a larger number of active than passive managers and are more likely to change their active managers.

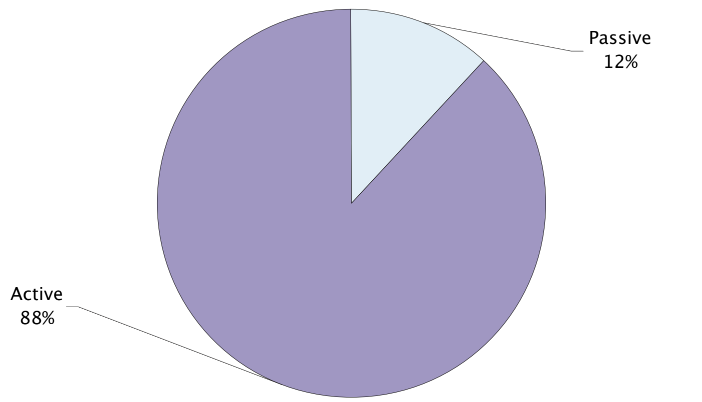


Chart 3.2.6: Breakdown of mandates by investment approach

Most of the manager selections analysed had the shortlist provided by an investment consultant. A small number, mainly local authorities had created the shortlist in-house.

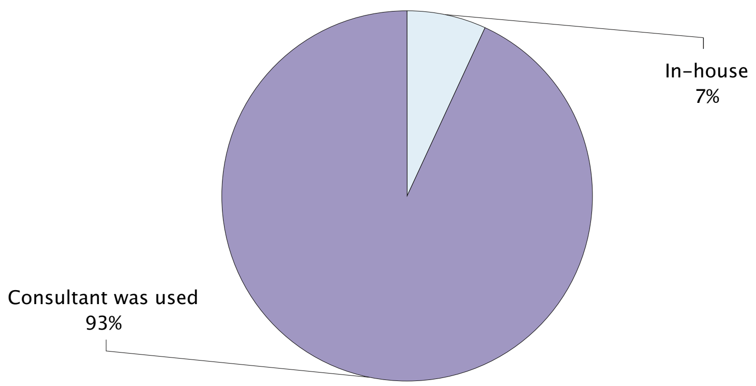


Chart 3.2.7: Breakdown between consultant and in-house provision of shortlist

3.3 Fund Manager Performance Data

Global Investment Performance Standard (GIPS) composite or AIMR-PPS performance records for each fund manager was used to measure the performance of segregated fund selections.

The appropriate Global Investment Performance Standard (GIPS) composite or AIMR-PPS performance records for each fund manager was used to measure the performance of segregated fund selections. Global Investment Performance Standards are a set of ethical principles that establish a standardised, industry-wide approach to how investment firms should calculate and report their investment results to prospective clients in a way that ensures fair representation and full disclosure. The GIPS standards were based on and preceded in North America by AIMR Performance Presentation Standards. AIMR-PPS standards converged with the GIPS standards on 1 January 2006.

These performance measures are most relevant for the analysis of the quality of shortlists and final selection for two reasons. Firstly, most pension schemes in selecting a fund manager choose the organisation rather than the specific person who will run their portfolio. Any difference between the actual fund return and the composite return will therefore relate more to chance than from a decision by the trustees. Secondly, fund managers are required under the GIPS principles to use their GIPS composite performance track records to illustrate their performance when presenting for new business. Consequently, selection decisions, as far as performance plays a part, will be based on the GIPS performance.

The database of GIPS composite performance records has been built from the Asset Manager Information (AMI) database provided by Mellon Analytics. This has been supplemented by data collected directly from fund managers where

a) their composite return history for a particular product was not included in AMI,

b) the data did not have a complete history and

c) fund managers do not contribute to AMI for any products.

A list of fund managers included in the analysis is shown in Appendix I.

When assessing the effectiveness of pooled mandates we have used the Mellon Analytics pooled fund universe performance data. This has again been supplemented with data collected directly from fund managers where necessary.

Fund managers generally calculate GIPS composite data for equity, bond, property and multi-asset mandates. Within these traditional asset classes, there are 127 selection processes which are suitable for analysis, 87 of which were completed in 2004 or earlier. It has not been possible to analyse in detail the quality of decision-making for those mandates with scheme-specific benchmarks or those from alternative asset classes. In addition, as the objective of passive funds is to match the index, analysis of the relative returns of these funds is not meaningful in the context of this analysis of fund manager selections.. They have therefore also been excluded from the analysis.

3.4 Performance of Selection Decisions

Respondents to the survey provided information on whether their manager was outperforming the objective. In Chart 3.4.1 mandates have been separated into the 127 mandates identified above where detailed analysis can be completed and other mandates, mainly alternative assets and those with scheme specific benchmarks.

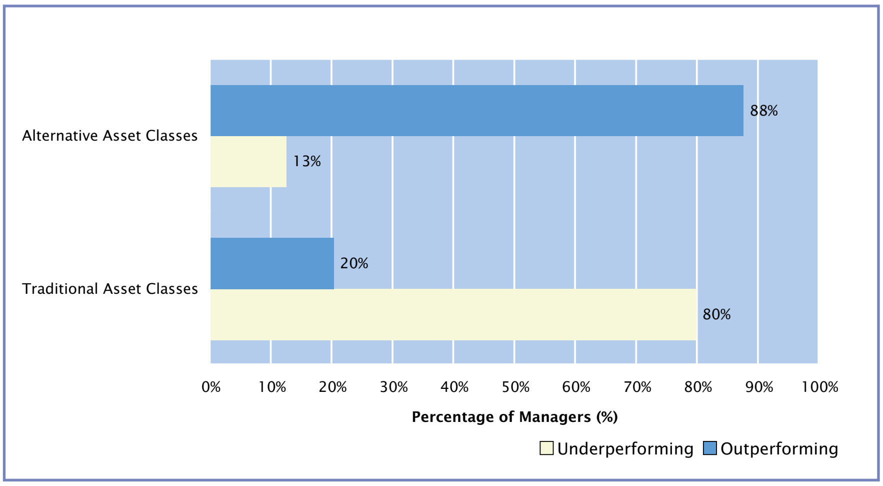


Chart 3.4.1: Managers outperforming and underperforming the objective net of fees since inception

20% of traditional mandates have resulted in outperformance..

As can be seen, 20% of traditional mandates have resulted in outperformance. This is consistent with the notion that investment consultants generally recommend performance objectives for equities, bonds and property such that only the top 25% of managers are able to achieve them in the longer term.

Almost 90% of alternative asset mandates and those with scheme specific benchmarks are currently outperforming their objective. However, a number of factors could explain the difference in the result. For example, there may be a higher level of skill amongst alternative asset managers. The objectives being set for these types of mandates may be less demanding. There may be greater scope in some of the new asset classes, such as currency, for all managers to outperform or there is an 'early adopter' effect.

49% of managers beating the benchmark net of fees

For those mandates where more detailed analysis could be completed, the performance compared to the benchmark net of fees since inception was calculated. The results are shown in Chart 3.4.2. As we would expect, the number of outperforming managers increases with 49% of managers beating the benchmark net of fees compared to only 20% that outperformed the mandate's objective.

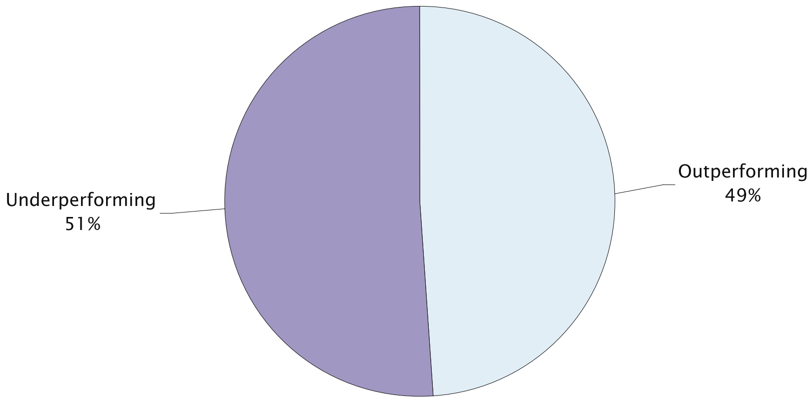


Chart 3.4.2: Managers outperforming and underperforming benchmark since inception

3.5 Impact of scheme size on performance

It has been suggested in the Myners report that "larger schemes are more likely to have the resources to recruit and train more knowledgeable trustees". If this is the case, is there any evidence that this leads to enhanced decision making in manager selection? Chart 3.5.1 compares the number of large and small schemes that have managed to outperform their objective, excluding alternative asset classes. The alternative asset classes have been excluded as they are more prevalent with larger schemes and would therefore skew any such comparison.

There is no evidence that large schemes enjoy any improvement in performance when compared to smaller schemes.

There is no evidence from our sample that large schemes (i.e. those over £1 billion) enjoy any improvement in performance from their fund managers when compared to smaller schemes. This result was insensitive to different thresholds for the classification between large and small schemes and was not changed by considering performance against the benchmark.

Section Three

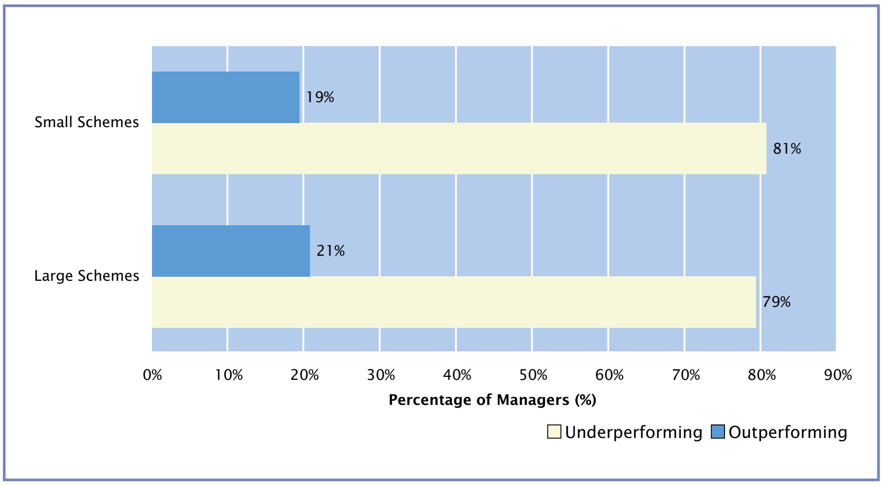


Chart 3.5.1: Manager performance at large schemes compared to small schemes for traditional asset classes

3.6 **Key Points**

- Only 20% of mandates have outperformed their objective net of fees since inception.
- 49% of managers have beaten the benchmark or index net of fees.
- There is no evidence that large schemes enjoy better performance from their fund managers than smaller schemes.

Section 4 : Manager Selection Process

4.1 Manager Selection at Pension Schemes

Pension schemes use a variety of approaches to select fund managers. This research focuses on the most common method; shortlisting of managers.

Pension schemes use a variety of approaches to select fund managers. This research focuses on the most common method; shortlisting of managers.

This involves the creation of an initial long list of managers, which is then refined into a shortlist of typically between two and five managers most appropriate for the specific mandate. The final selection is then made from this shortlist. It is normal practice at most schemes for a beauty parade of the fund managers on the shortlist to take place before the fund manager is chosen.

Since the costs of researching fund managers are high, most pension schemes will use an investment consultant, that enjoy considerable economies of scale, to provide the long and shortlist recommendation. The final decision is normally taken by the trustees of the pension scheme often based on advice from their investment consultant or a recommendation from their investment committee. At some schemes this final decision is delegated to the investment committee or less commonly the investment consultant.

The responsibility for selecting fund managers and the parties that provide recommendations varies across pension schemes. Chart 4.1.1 highlights the dominant parties who influence the final selection of fund manager.

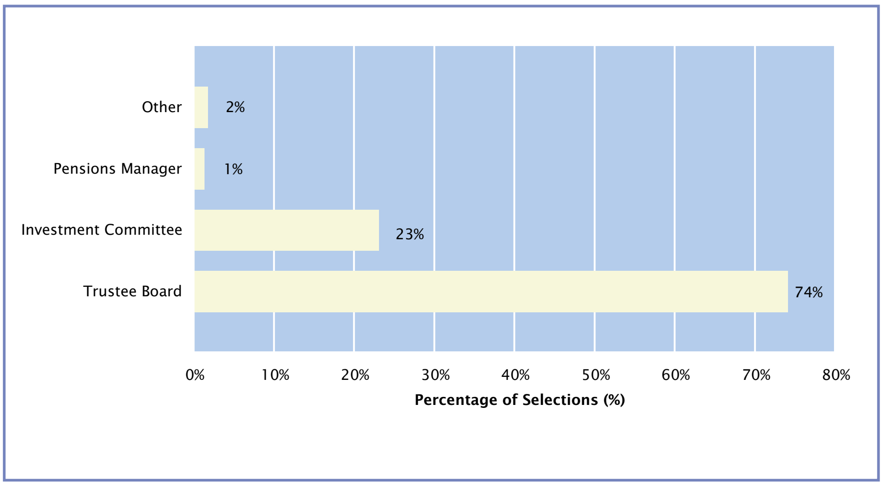


Chart 4.1.1: Breakdown of who took the manager selection decision

At over 70% of the manager selections analysed, the trustee board took the final decision..

At over 70% of the manager selections analysed, the trustee board took the final decision. In most cases where the trustee board did not take the final decision it was delegated to an investment committee of trustees. At many schemes these investment committees have been set up in response to the Myners report which recommended that their formation could improve decision-making. The data presented here originates from fund manager selections from the last six years. Many of these were completed before schemes had an opportunity to implement the recommendations of the Myners report. We would therefore expect the proportion of decisions taken by investment committees to increase in the future.

Section Four

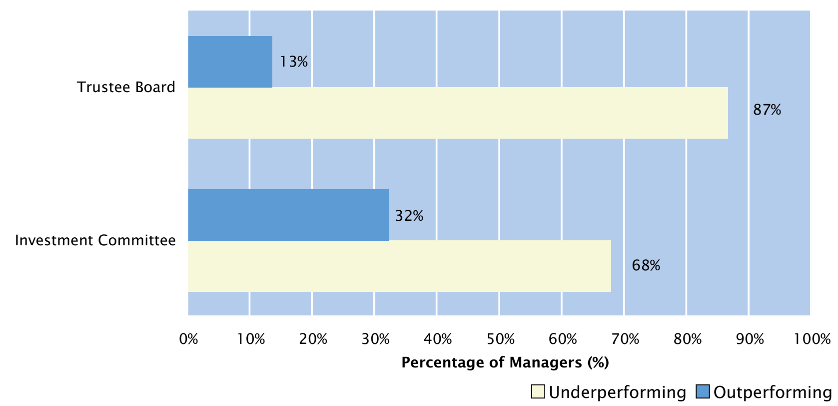


Chart 4.1.2: Manager selection by trustee boards versus investment committees

Chart 4.1.2 compares the success of decisions taken by trustee boards and investment committees to see if there is any early evidence of enhanced decision-making by investment committees.

Investment committees do appear to be more effective than trustee boards in selecting fund managers.

Investment committees do appear to be more effective than trustee boards in selecting fund managers.

Where the trustee board took the decision they often received a recommendation either from the investment committee or their consultant. Data was collected on who made a recommendation but the analysis does not include information on whether the recommendation was followed.

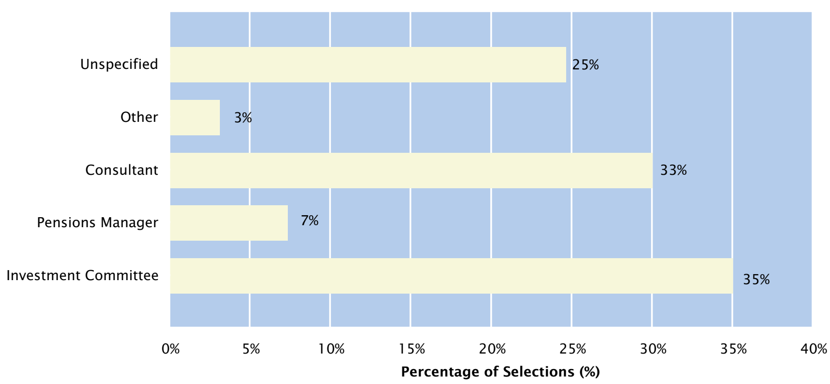


Chart 4.1.3: Breakdown of who made a recommendation

Recommendations were most frequently made by the investment consultant and the investment committee. Is there any evidence to suggest that these recommendations improved decision-making?

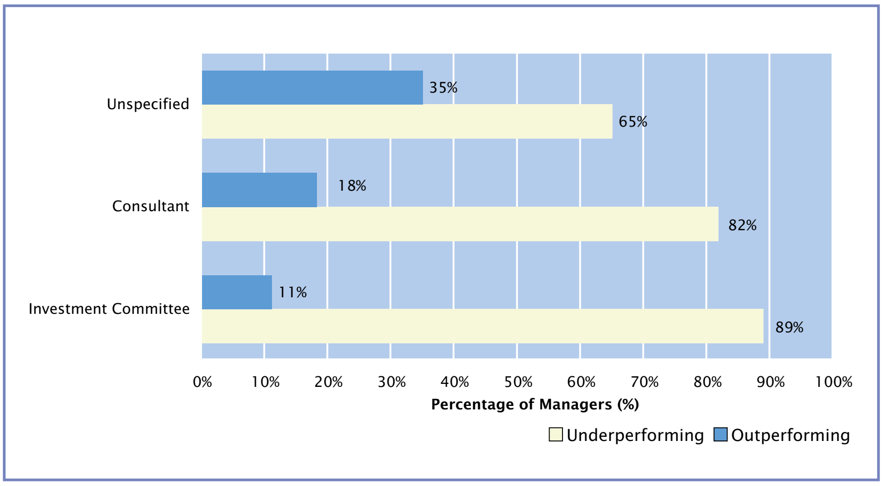


Chart 4.1.4: Impact of recommendation on the final decision

Chart 4.1.4 indicates that recommendations received from the investment consultant on the final selection produced a better outcome than where the recommendation was received from the investment committee. However, in both cases the number of successes was less than where no clear recommendation was received. As stated previously, it is not clear if the recommendation was followed by the trustees and this may be a factor in understanding this result.

4.3 **Key Points**

- This report analyses only the shortlist decision-making approach to selecting fund managers.
- Over 70% of final decisions were taken by the full trustee board and 23% by investment committees.
- Investment committees appear more effective than trustee boards in selecting fund managers.
- No benefit to final fund performance was apparent as a result of a recommendation from the investment consultant or investment committee on which fund manager to appoint.

Section Four

Section 5 : Perception of Advice

5.1 Background

A key element in the success of the manager selection and monitoring process is the relationship between the pension scheme and their investment consultant. Few pension schemes currently undertake measurement of the effectiveness of the advice they receive from their investment consultants in selecting and monitoring fund managers. In the absence of performance information, perceptions of the quality of the advice will largely be based on the effectiveness of their service and their support to the trustees in helping them take decisions.

Most pension schemes retain the same investment consultant for all aspects of their investment advice including setting the strategic benchmark, defining the funds' investment structure (e.g. the proportion in passive or active investment) and the selection and monitoring of their investment managers. Therefore pension schemes may be unable to separate out their views on each element of the investment process and instead be providing an overall rating of their consultant's advice.

5.2 Overall Value

70% of pension schemes felt the overall value they received from their investment consultants was good or very good.

70% of pension schemes felt the overall value they received from their investment consultants was good or very good, 23% rated the overall value as average and 5% as poor or very poor. Clearly, there is a high level of satisfaction amongst pension schemes with regard to their investment consultants.

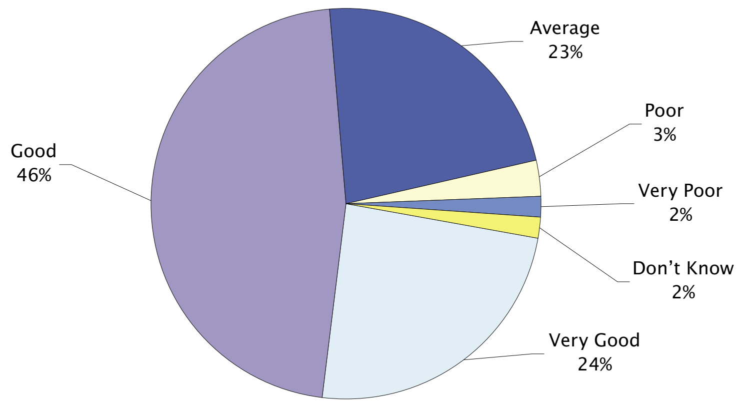


Chart 5.2.1: Assessment of Overall Value

5.3 Quality of Service

Pension schemes rated their investment consultants highly in this regard with 81% feeling their quality of service was good or very good

Pension schemes rated their investment consultants highly in this regard with 81% feeling their quality of service was good or very good, 15% rating them as average and only 4% as poor or very poor.

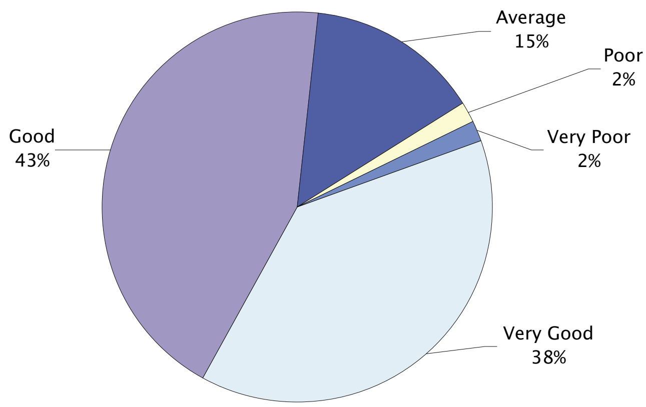


Chart 5.3.1: Assessment of quality of service

5.4 Quality of Advice

82% of pension schemes rated the quality of advice as good or very good.

The recent NAPF guide to good practice entitled 'Trustees' Self-assessment of their Performance and Assessment of their Third Party Providers' stated that "the most important issue is the quality of the advice and not the efficiency with which the advice is delivered". 82% of pension schemes rated the quality of advice as good or very good, 11% as average and only 3% as poor.

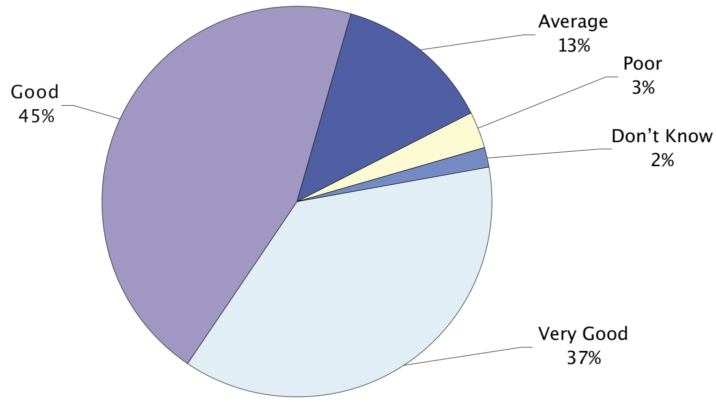


Chart 5.4.1: Assessment of quality of advice

To what extent is the perception of quality of advice related to the performance of the fund manager? It is normal for the perception of quality to relate to the outcome of the advice. In Chart 5.4.2 the proportion of fund managers that were reported by the pension scheme as outperforming their objective were compared with the rating of the quality of advice. This gives an indication of the strength of the relationship between perception and outcome.

Over 40% of those pension schemes that believe the quality of advice is good or very good have fund managers that are failing to achieve their objective..

Over 40% of those pension schemes that believe the quality of advice is good or very good have fund managers that are failing to achieve their objective. This increases to over 60% for those rating the quality of advice as average or poor. Surprisingly, almost 40% of those that rate the quality of advice as poor have fund managers that are currently outperforming. Clearly, there is often a mismatch between the observed performance of the fund manager and the perception of the quality of advice at pension schemes.

Section Five

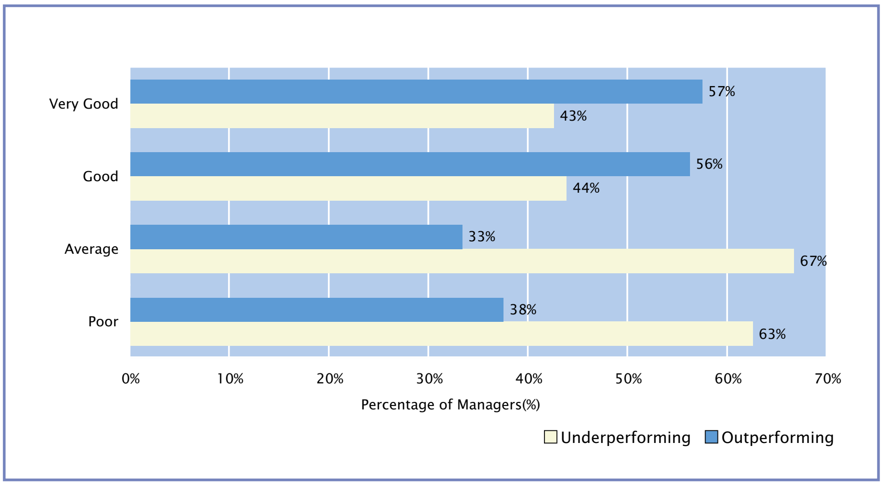


Chart 5.4.2: Manager performance relative to performance objective versus perception of quality of advice

Many pension schemes when faced with an under or outperforming fund manager apparently do not believe that the quality of advice bears a strong relationship to this under or outperformance.

Many pension schemes when faced with an under or outperforming fund manager apparently do not believe that the quality of advice bears a strong relationship to this under or outperformance. Where the manager is underperforming and the trustees decide to appoint a new manager they are therefore more likely to proceed with the same adviser. Given the costs involved with manager searches and the impact an underperforming manager can have on the assets of a pension scheme, understanding the relationship between advice and subsequent performance is vital for pension schemes.

5.5 **Key Points**

- 70% of pension schemes felt the overall value they received for manager selection from their investment consultants was good or very good.
- 89% of pension schemes felt that the quality of service was good or very good.
- 82% believed the quality of advice was good or very good.
- The perception of the quality of advice is often not related to the performance of the fund manager.

Section 6 : Shortlist Construction

6.1 Background

Those managers considered most likely to achieve the performance objective for the mandate within the given style and risk constraints will be included on the shortlist by the investment consultant. In creating shortlists of managers, factors such as the philosophy, culture, staff retention policy and buy and sell disciplines at each fund manager will be considered in arriving at a judgement of those most likely to outperform in the future.

Academic evidence has shown that there is no persistence in fund manager track records over the longer term. The exception to this is the performance records of the poorest managers (fourth quartile) that have been shown, in some studies, to have a higher probability of being fourth quartile in the future than other fund managers. It is therefore to be expected that historic track records will not be a major criteria for selection. Indeed many consultants argue that it is their ability to look behind the performance records which underpins the value added in their advice. If so, we would expect to see little or no bias in the shortlists put forward by consultants with regard to past performance.

6.2 Influence of past performance

To establish whether there is any past performance bias in the recommendations of consultants, the performance of each fund manager on the shortlist was analysed. This analysis is based on their GIPS composite track record in the three and five years prior to recommendation. These track records were then grouped by quartile ranking to establish if past performance is a factor. If past performance is not a factor in recommendations we would expect 25% of the recommendations to be in each quartile mirroring the universe of all managers.

6.2.1 Equities

48% of recommendations being top quartile over the previous five years and 36% top quartile over the previous three years.

The research suggests that past performance plays a significant role in selecting managers for equity mandates with 48% of recommendations being top quartile over the previous five years and 36% top quartile over the previous three years.

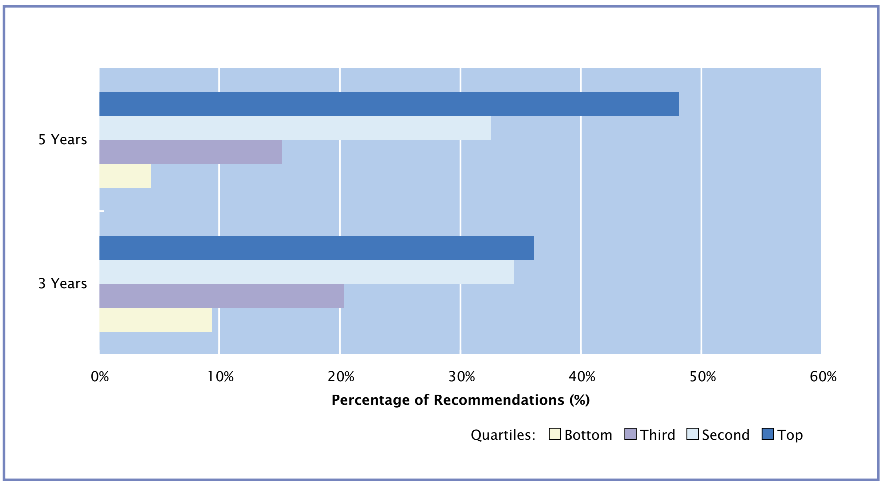


Chart 6.2.1: Past Performance: Percentage of equity manager recommendations in each quartile

Section Six

It appears from the above result that consultants are influenced by past performance in their recommendations of equity fund managers. However, this does not necessarily mean that past performance is the dominant factor in consultant assessment of fund managers. If not, what possible explanations could there be for this result? We consider three possible explanations:

a) When selecting fund managers for recommendation to trustees consultants may be inclined to select those managers they believe will be most acceptable to trustees. It will inevitably be easier to present managers with a strong performance track record and, consequently, there may well be a bias towards putting such managers forward on shortlists.

b) Consultants, already aware of the performance of a fund manager from client meetings, may be more likely to form a more positive view of the fund manager if their performance is positive. The opposite may be true when meeting with managers with poor performance. Consequently, consultants may believe they are selecting managers on the basis of an analysis of their investment approach and methodology whilst their judgements have been subconsciously affected by an awareness of the historical track record of the manager.

c) A third possible reason relates to the behaviour of fund managers. When their performance is poor they may put greater emphasis on client relationships in order to reduce the likelihood of client losses. Consequently, they may spend less time trying to gain new business and get onto consultant shortlists.

Those managers that outperform in the future are as likely to come from managers ranked in the third quartile on historic performance as they are from the top quartile. Consequently, this bias towards the top quartile is an inefficient use of research capability as opportunities amongst other managers, not in the top quartile, will be missed. This inefficiency is not necessarily bad for pension schemes as long as consultants have the skill to pick those managers that will outperform in the future from those currently in the top quartile. The assessment of consultant value added in Section 8 concentrates on the performance of shortlists in aggregate and does not separate out the effectiveness of recommendations ranked by historic performance. We will return to this issue of the consistency in consultant value added across the historic performance quartiles in future reports.

6.2.2 Bond and Property Mandates

The results for bond and property shortlists are different to those for equity shortlists. A majority of the recommendations based on past performance are in the second and third quartile with few in the top quartile. Why should this be case when in equities past performance is highly significant?

A majority of the recommendations based on past performance are in the second and third quartile.

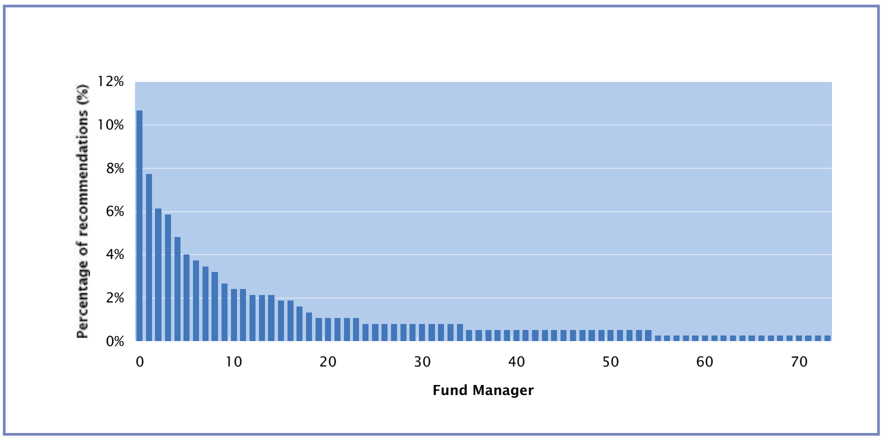
The results suggest that in selecting bond managers consultants may have placed emphasis on the manager's ability to manage risk more highly than their ability to capture excess returns. The new focus on making assets work harder together with an increase in bond weightings at many schemes may lead to a change in emphasis in research. It will be interesting to see whether or not such a change heralds a change in consultant behaviour with regard to the importance of past performance.

Unlike equity management it is not as easy for property fund managers to scale their investment expertise. They cannot buy more of the buildings they already own to invest new money but have to find new properties. Each new property then requires to be managed to maximise the returns. Consultants may consider property firms that are best placed to manage this growth are firms that already manage a substantial property portfolio with significant resources. This resources factor may outweigh past performance as a key driver in consultants recommendations of property managers.

6.3 Concentration

Investment consultants have the universe of fund managers to choose from for any particular product group. In some of these product groups such as passive or index tracking portfolios, currency management and liability driven investment the number of fund managers offering a meaningful service is limited. It is therefore inevitable that consultants will tend to focus on the same product providers. However, in areas such as equity and bond investment there is a significant number of managers offering relevant products. The opportunity for variation between consultant recommendations is therefore significant. The extent to which consultants recommended the same fund managers for active equity mandates over the last five years is highlighted in Chart 6.3.1.

Chart 6.3.1 Frequency of equity manager recommendations



Ten managers have enjoyed 50% of all recommendations while 80% of recommendations have been shared by just 30 managers.

Ten managers have enjoyed 50% of all recommendations while 80% of recommendations have been shared by just 30 managers. The chart suggests that there is a core group of managers recommended by all consultants. Variation between consultants is therefore more likely to be at the margin of recommendations.

Section Six

Should pension schemes be concerned about this concentration in fund manager recommendations? The key concern would be if this caused an adverse effect on the performance of those fund managers most recommended and ultimately selected. In institutional investment management it is often expected by trustees that the fund manager will attend the beauty parade and also become involved in client reporting. A large increase in clients together with an increased marketing burden from new sales pitches could divert the fund manager from their key function of managing the assets with a detrimental impact on performance. This is an area which requires further analysis. In the meantime, it may be prudent for consultants and trustees to consider whether requiring the fund manager to be present at beauty parades and client meetings may ultimately have an adverse impact on their performance.

If concentration in equity recommendations is considered to be an issue, one way to address this would be for consultants to recommend more managers from the second and third quartiles. However, trustees may not welcome such a change if they expect to see top performing managers on shortlists. To offset this, trustees may need to review their understanding of the relevance of past performance in selecting fund managers.

6.4 **Key Points**

- Past performance plays a significant role in selecting managers for equity mandates with 48% of recommendations being top quartile over five years and 36% top quartile over three years.
- The findings suggest that Bond and property shortlists are not influenced by a top quartile past performance history.
- Concentration of recommendations across consultants is higher than expected suggesting consultants recommend the same core managers.
- 50% of equity recommendations have been shared by ten fund managers.

Section 7 : Assessing shortlist effectiveness

There is no single way of assessing the effectiveness of a shortlist. A number of different perspectives could be considered as relevant and each trustee body will have their own view on what is a good shortlist. For example, most trustees would expect that each manager on the shortlist recommended by the consultant would be capable of achieving and exceeding the objective over the time horizon of the mandate. On the other hand, some trustees may focus on the ability of the consultant to ensure that the shortlist does not contain managers that are more likely to under-perform whilst hopefully identifying managers that will achieve the strongest performance. In reality each of these aspects should be important to pension schemes in assessing their advisers, whilst the importance of each aspect will vary from scheme to scheme.

A range of measurement methodologies that capture the different characteristics of shortlists.

To reflect this we need to use a range of measurement methodologies that capture the different characteristics of shortlists. The measures used are described more fully in Section 7.2 below.

7.1 Fund Manager Performance Data

All the measurement methods used in this analysis utilise a universe of relevant GIPS composite performance for each fund manager by product type. For example UK equity mandates were measured against track records of fund managers providing UK equity fund manager services. Where no GIPS composite data is available for a particular product group, it was not possible to carry out an assessment of the effectiveness of a shortlist as there is no consistent way to compare the performance of fund managers included on the shortlist and in the wider universe. Consequently, the analysis of shortlist effectiveness and trustees selection will only cover equity, bond, property and multi-asset mandates. More specialist mandates or scheme specific mandates such as currency, total return and hedge funds are therefore not analysed. A list of the fund managers and universes used in this analysis can be found in Appendices I and II.

The analysis of shortlist effectiveness and trustees selection will only cover equity, bond, property and multi-asset mandates.

7.2 Methodology

7.2.1 Binomial Approach

The effectiveness of a shortlist can be judged by the number of managers on the shortlist that managed to achieve the specific performance objective over subsequent periods within the prescribed risk constraint. However, simply knowing the number of managers on a shortlist that achieved the objective is not sufficient to allow us to comment on the value added by the consultant in recommending those managers. Imagine a situation where all managers on the shortlist achieved the objective. The initial reaction may be to assume there was significant skill in putting forward this shortlist. However if when we looked at the performance of all fund managers providing a similar product, we discovered that everyone had also achieved the objective it would be apparent that no skill would have been required to select such a shortlist. On the other hand, if only 10% of all fund managers had achieved the objective over the period in question then selecting a shortlist where each manager achieved the objective would require considerable skill.

To assess a shortlist we therefore have to first determine the number of managers in the universe that achieved the objective. We then compare the actual number of successes on the shortlist to the number of successes in the universe. This comparison is done using binomial statistics and enables the probability of achieving the number of successes on the shortlist, or a more extreme outcome, to be derived. This probability forms the basis of the binomial score. In our presentation of the results we have set a score of zero to equal the expected outcome. Positive scores then represent value added and negative scores the opposite.

This analysis was performed on both the risk and return of the shortlist and universe. However, as performance records of fund managers in the universe have been selected so that the objective and risk tolerance of the product are similar to that of the mandate being analysed, we expect most to have operated within the risk tolerance. Therefore, as the majority of managers will operate their product within the risk constraint, the opportunity for consultants to add value in this area will be limited.

7.2.2 Sampling Approach

Another way to quantify the effectiveness of a shortlist is to compare it against all other shortlists that could have been put forward by a consultant. To do this, all possible shortlists that could have been presented by the consultant are generated.

The GIPS performance track records for each product group for all fund managers were collected. These track records then provide a performance universe for each product group. From this the universe of all possible shortlists containing the same number of managers can be created. For example, 595,665 different four manager shortlists can be created from the 63 individual manager track records in our UK equity universe. The performance of the shortlist being analysed is compared to the universe of possible shortlists from the appropriate product group to establish the value added according to the following criteria.

7.2.2.1 Avoidance of poor performing managers

Trustees will clearly expect the shortlist to avoid those managers with the poorest performance, post the hiring decision. To measure the effectiveness of the consultants in avoiding the poorest managers, all shortlists, in our universe of shortlists, are ranked according to the performance of the poorest performing manager. The ranking of the actual shortlist indicates how well it has avoided these managers. As with the binomial approach we have set the expected value or mean to equal zero on our charts. Positive values then represent value added and negative values represent value reducing recommendations. The maximum positive and negative scores are 50.

7.2.2.2 Capture of best performing managers

Whilst trustees will generally be content to select a manager that outperforms there may be the desire to be invested with one of the top rated managers. We approach the measurement of this in the same manner as the 'avoidance of poor performing managers' but in this case the ranking is done according to the best performing manager on the shortlist. Again the expected value is set to zero and positive scores represent the ability of the consultants to identify the top performing managers and negative scores, the opposite.

7.2.2.3 Shortlist Aggregate Performance

The aggregate performance of each shortlist is calculated by assuming that each manager on the shortlist was given an equal proportion of the assets to manage on a buy and hold basis at the time of the shortlist recommendation. Shortlists are ranked on the basis of their aggregate performance. The recommended shortlist can then be compared with this ranking of all possible shortlists. To be consistent with the previous measures the expected value is set to zero and positive scores represent value added.

Section 8 : Shortlist effectiveness - Results

8.1 Background

Despite pension schemes using consultants to help them select fund managers there is still no clear understanding of the value added by consultants in this area. There are a number of different scenarios that could describe the consultant's ability to add value in choosing fund managers each of which would produce a different profile of results in the analysis. The main scenarios we could expect to observe are;

a) Consultants are able to identify managers likely to outperform in the short term but are unable to identify, in a consistent way, those that are able to outperform over longer periods. If this scenario existed we would expect to observe value added from the shortlist in the early years with a gradual decay in the value added over time.

b) Consultants are able to identify managers that have skill. However, in the shorter term this skill may not be evident as chance events can overwhelm the fund manager's performance advantage. As the time period extends the element of chance decreases and the manager's skill becomes more evident. The observation of the value added from shortlists for such a scenario would show a random outcome or slight value added in the early years with evidence of value added increasing as time progressed.

c) The potential value added by consultants to the manager selection process may not be sufficiently high to be identified in a shortlist of managers. If this were the case we would observe no bias towards value added in our analysis and the outcomes would be random.

The following results will help to form an initial picture of the value added by consultants in the manager selection process.

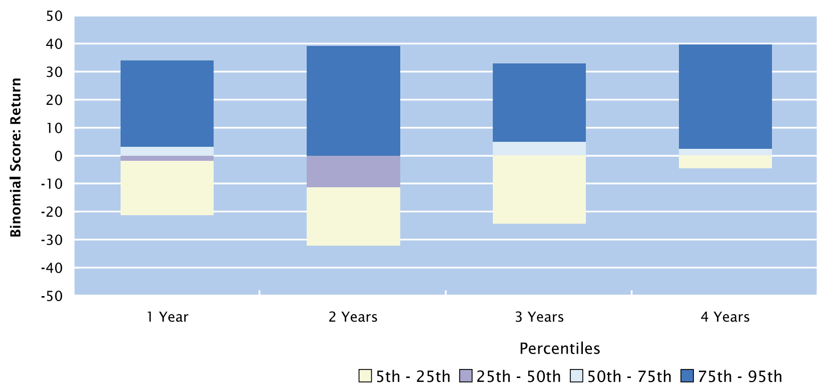
8.2 Results – All mandates over time

8.2.1 Binomial approach – Return

The binomial score based on excess return measures the value added from shortlists. It assesses whether the number of outperforming managers is different to the number that would be expected given the number of outperforming managers in the universe. Values above zero in Chart 8.2.1.1 represent shortlists where the selection was better than would be expected from random selection and values below zero where the shortlist selection was worse than expected. These have been calculated for different periods from one to four years following the manager appointment date. The number of shortlists collected so far for the year 2000 and earlier is too small to produce sufficient data for the analysis for periods beyond four years.

Values above zero represent shortlists where the selection was better than would be expected from random selection.

Chart 8.2.1.1: Binomial Score for different periods post selection process - return



Where non-zero values have been observed there is a slight positive bias in the early years which becomes far more pronounced by the four year time period.

The chart highlights those shortlists where value was either added or removed by the advice. A large number of shortlists were no better or worse than had the shortlist been selected at random from the appropriate universe. These have been given a score of zero. At one and two year durations, there are 45% of shortlists with a score of zero, at three years 52% and at four years 56%. Where non-zero values have been observed there is a slight positive bias in the early years which becomes far more pronounced by the four year time period. This is highlighted by only 11% of results being negative four years after the selection process.

8.2.2 Binomial Approach – Risk

The binomial score for risk measures the value added from shortlists through the avoidance of managers that fail to operate within their specified risk constraints. It is only calculated for periods of at least 36 months to ensure a meaningful result and property funds have been excluded because of the distorting effects of smoothing on the calculation of volatility.

Fund managers products are typically defined by a performance objective and an appropriate level of risk tolerance. Most fund managers will ensure that the risk of the fund remains within the specified risk tolerance for the fund but have more difficulty in consistently meeting the performance objective. If virtually all managers operate within their risk objective the opportunity for consultants to add value in identifying managers with superior risk management is generally extremely limited.

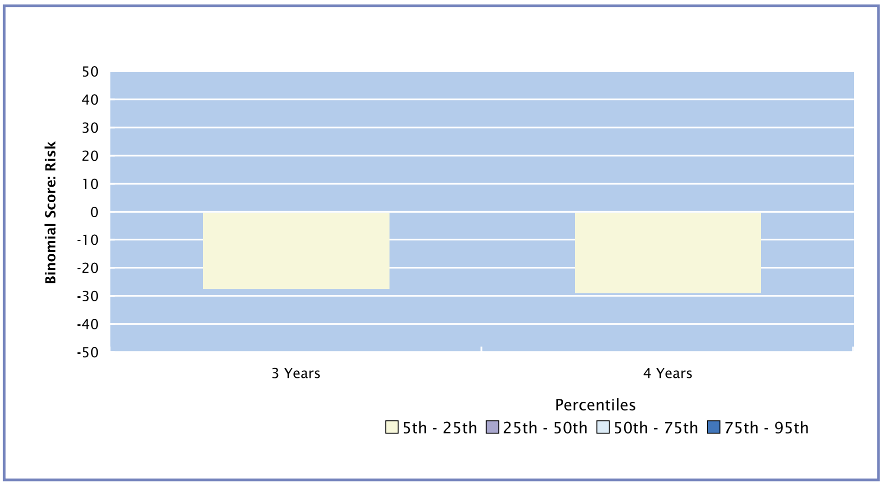


Chart 8.2.2.1: Binomial Score for different periods post shortlist process - risk

Chart 8.2.2.1 confirms that there is virtually no opportunity for consultants to add value by identifying managers with superior risk control. Most outcomes are zero with 84% zero over three years and 89% zero over four years.

8.2.3 Avoidance of poor performing managers

Shortlists can generally be regarded as adding value if they avoid the worst managers. This reduces the chance that trustees select a poor manager from the shortlist. The avoidance of poor performance ranking, rates shortlists on how well they avoid the poorest performing managers.

As the time extends to three and four years there is a significant gain from the consultants' advice.

In Chart 8.2.3.1, if consultants were not able to add value by avoiding the poorest performing managers then the median point of these distributions would be zero and the 25 and 75 percentile points of the distribution would align with rankings of -25 and 25. Over shorter periods of one and two years there is a slight improvement over the results that could be expected if consultants had no skill. Furthermore, as the time extends to three and four years there is a significant gain from the consultants' advice. Over both three and four years a significant majority of shortlists demonstrated value added in avoiding the poorest performing managers while at four years we also see a significant shortening in the tail.

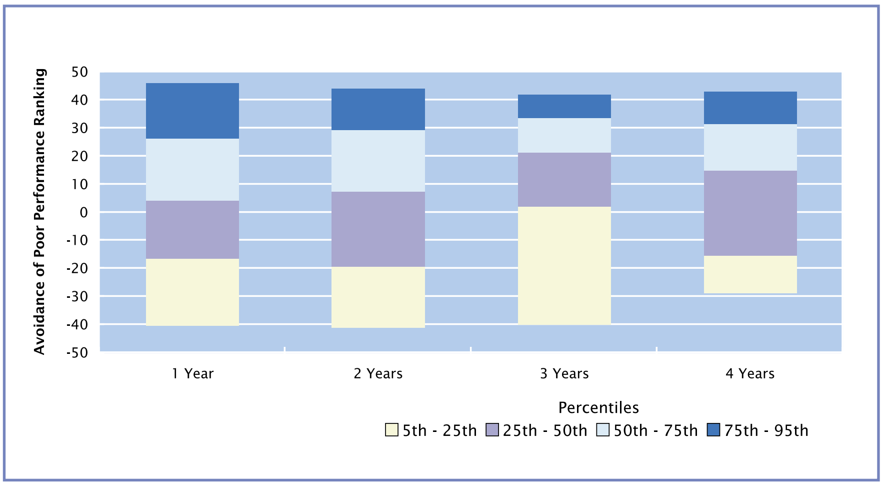


Chart 8.2.3.1: Avoidance of poor performing managers over time

8.2.4 Capture of top performing managers

This performance ranking highlights the ability of consultants to include the top performing managers on their shortlists.

There were a number of shortlists that contained the best performing manager over subsequent periods following the selection process. These shortlists are ranked with a score of 50 indicating the high level of value added. As can be seen in Chart 8.2.4.1 the median of each distribution fluctuates around zero. The distribution for each time period is positively skewed with a much larger positive skew over the longest time period analysed. Despite this positive skew, it should be noted that in providing shortlists consultants are unlikely to be seeking to recommend the best performing manager. These top performing managers may well be associated with a more aggressive approach and consequently could be less appropriate for some pension schemes. Nonetheless, Chart 8.2.4.1 does suggest that consultants are still able to bias their advice towards the better performing managers.

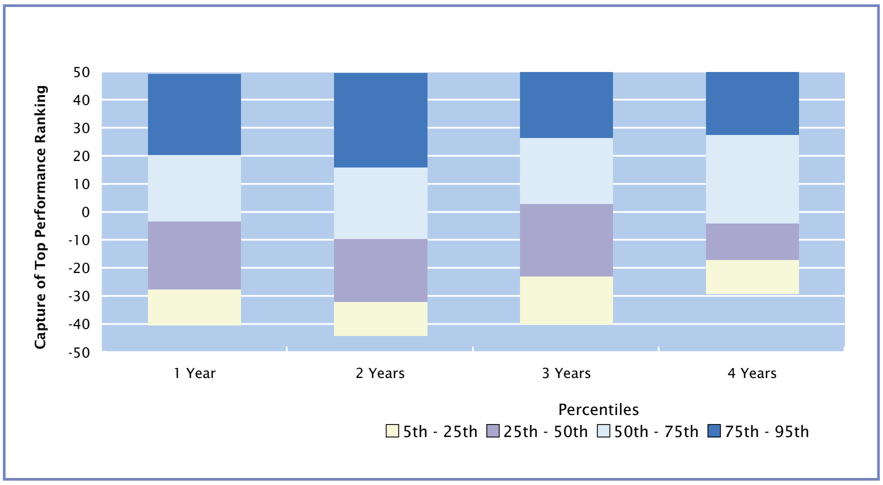


Chart 8.2.4.1: Capture of top performing managers over time

8.2.5 Aggregate Return Ranking against sampling universe

The aggregate return ranking is a measure of the value added in selecting a combination of managers that produces the greatest combined return. It treats each shortlist as a multi-manager type portfolio but does not allow any change in the

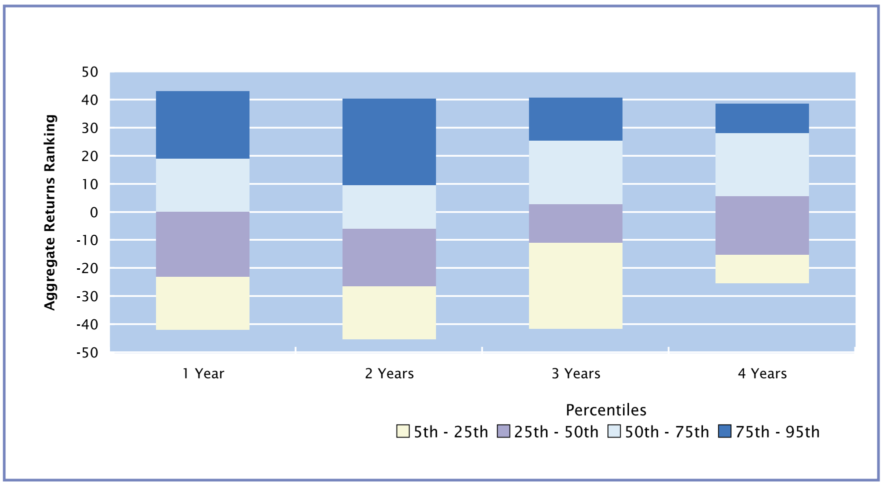


Chart 8.2.5.1: Aggregate return ranking over time

At four year time periods there is evidence of a positive skew in the results with the negative tail shortening.

managers over time. The result can be significantly influenced by the inclusion of one manager with extreme returns.

Over shorter time periods there is no evidence of value added by consultant shortlists. However, at four year time periods there is evidence of a positive skew in the results with the negative tail shortening significantly. This result is consistent with the earlier results of an improvement in the avoidance of the worst managers and capture of best performing managers over longer time periods.

8.2.6 Conclusion

Consultants are able to identify skilful fund managers.

Based on the data sample, the results observed are consistent with the findings of Goyal & Wahal; that consultants are able to identify skilful fund managers. However, in the shorter term a wide spread of results is observed. As the time since selection increases, the effect of selecting more skilful managers on the shortlist begins to emerge more clearly. This effect is observed in three of the shortlist measurement approaches focusing on return.

The opportunity for consultants to add value by selecting managers with superior risk management is negligible. Most fund managers appear able to maintain there fund's risk within the required risk constraints.

8.3 Results – All mandates by Asset Class

Given that there is evidence of value added overall from investment consultants in choosing fund managers it is important to observe how these results may vary by asset class. The following charts highlight the value added by asset class over all time periods.

8.3.1 Binomial Methodology - Return

Consultants have a better success rate in recommending equity and property managers than bond managers.

It is apparent from Chart 8.3.1.1 that, based on the shortlists analysed, consultants have a better success rate in recommending equity and property managers than bond managers. All bond shortlists analysed show either a neutral result under the binomial methodology or a negative result with no positive outcomes. 64% of these bond mandates had a zero score compared to 47% for equity and 45% for property.

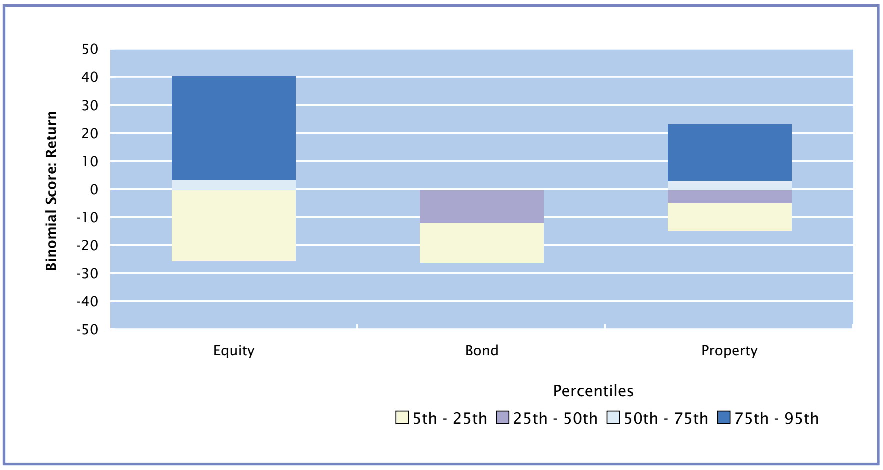


Chart 8.3.1.1: Binomial score by asset class – return

8.3.2 Binomial Methodology - Risk

Due to the smoothing of property performance data the calculation of risk levels based on monthly fund volatility has no meaning for property portfolios. Consequently, property funds have been excluded from this part of the analysis.

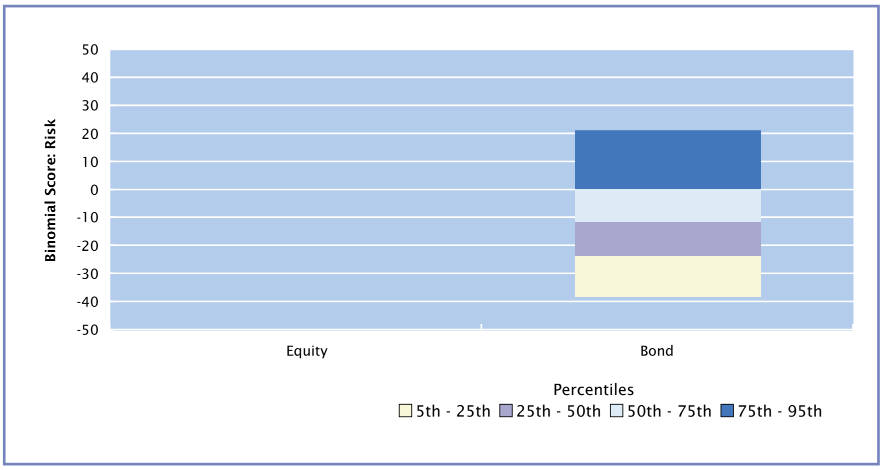


Chart 8.3.2.1: Binomial score by asset class – risk

In equity markets virtually all managers operated their fund within the prescribed risk constraints leaving virtually no opportunity for consultants to add value in their recommendations on risk control.

As can be seen in Chart 8.3.2.1 consultants are unable to demonstrate any value added in recommending equity managers that are more likely to maintain the appropriate risk level. All outcomes were zero. In equity markets virtually all managers operated their fund within the prescribed risk constraints leaving virtually no opportunity for consultants to add value in their recommendations on risk control.

The position in bonds is somewhat different with only 18% of shortlists having a zero value and a significant range of results across other shortlists. This difference we believe can be largely explained by the collapse in volatility in bond markets in recent years. As bond market volatility fell, the risk models used by bond managers were slow to adjust to the new environment, consequently forecasting risk at too high a level. Bond managers therefore tended to have too little risk in their portfolios for the actual market conditions with the result that many failed to maintain their ex-post risk within the guidelines set out for the fund. The potential for consultants to add value by identifying bond managers that maintained appropriate risk levels was therefore increased.

8.3.3 Avoidance of poor performing managers

The ability of consultants to add value by avoiding the poorest performing fund managers varies across the asset classes.

The ability of consultants to add value by avoiding the poorest performing fund managers varies across the asset classes. Chart 8.3.3.1 suggests that their ability to do this is greater for equity and property mandates than for bonds.

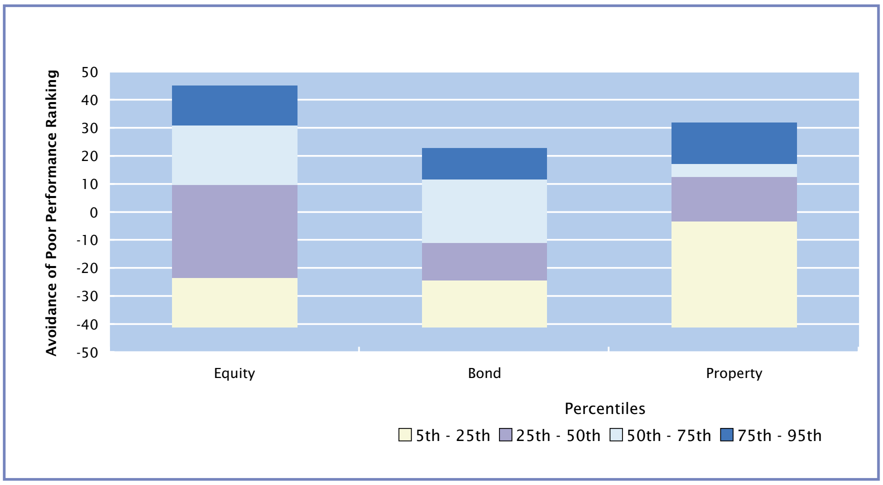


Chart 8.3.3.1: Avoidance of poor performance by asset class

8.3.4 Capture of top performing managers

There is no evidence that consultants are able to identify the best performing managers in any asset class. As can be seen in Chart 8.3.4.1 the distribution is more diverse for equities than bonds but in each case the median is below zero. As stated previously, this measure should be viewed with caution since consultants may not be attempting to identify the best manager but simply source managers that are appropriate for each specific mandate shortlist.

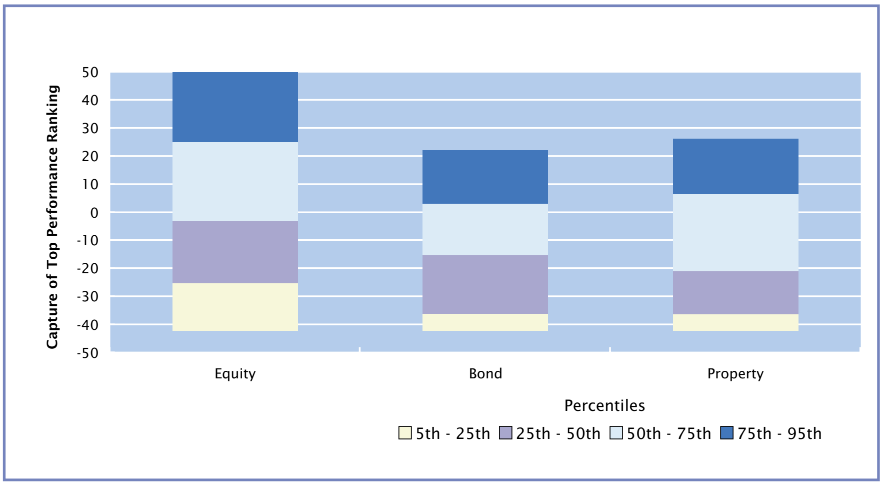


Chart 8.3.4.1: Capture of top performance by asset class

8.3.5 Aggregate Return Ranking against sampling universe

Equity shortlists show a slight positive bias, as well as a wider spread than the other asset classes.

A majority of bond and property shortlists produce an aggregate return since inception that ranked in the lower half of the distribution of all shortlists. By contrast equity shortlists show a slight positive bias, as well as a wider spread than the other asset classes.

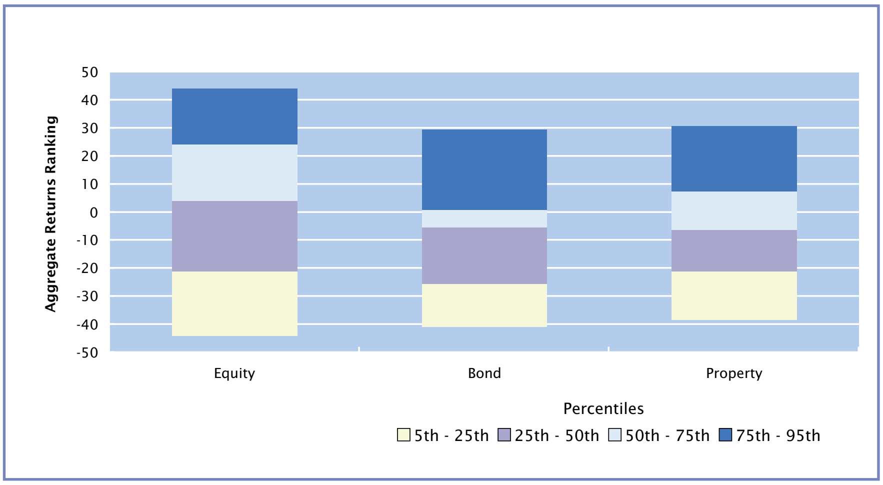


Chart 8.3.5.1: Aggregate Return Ranking by asset class

8.3.6 Conclusion

Shortlists for equity and property mandate selections generally provide more value added in selecting outperforming fund managers than those for bond mandates.

Shortlists for equity and property mandate selections generally provide more value added in selecting outperforming fund managers than those for bond mandates. In fact, no positive scores were observed for bond manager selections using the binomial methodology.

Against a more difficult risk environment, consultants found the recommendation of managers able to manage their bond portfolios within the risk constraints more problematic.

The generally poorer performance in recommending bond managers is concerning given the current emphasis on increasing bond weightings at most pension schemes. It is possible that historically consultants placed less emphasis on bond manager research than equity manager research given the greater importance of equity management to pension schemes. It may be that this emphasis has now changed to reflect the current importance of bonds. If so, we can expect to see an improvement in the value added from bond shortlists in the future.

8.4 Relationship between quality of advice and scheme size

In many industries larger clients get a higher quality of service and advice from their providers and will typically have a more senior person working on the account. In the area of investment consulting, it is a challenge for each consultant firm to ensure that all clients receive the same level of service and advice. The findings of Goyal & Wahal highlighted the better performance of large schemes compared to small schemes in the US. This could suggest that they receive better advice from their consultants than small schemes. Is there any evidence to support this in the UK?

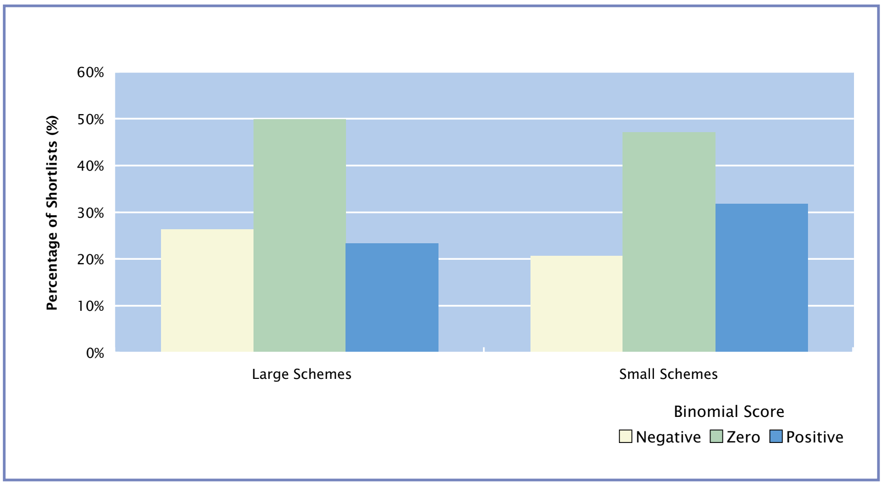


Chart 8.4.1: Quality of shortlist by scheme size

Chart 8.4.1 compares the quality of shortlists recommended to larger pension schemes with that provided to smaller pension schemes using the binomial assessment of added value.

There is no evidence that larger schemes enjoy a higher quality of advice than smaller schemes.

As can be seen from the chart there is no evidence that larger schemes enjoy a higher quality of advice than smaller schemes. In fact over 30% of the advice given to smaller firms was positive compared to only 23% of advice for larger schemes.

8.5 Relationship between advice and outcome

Section 5 highlighted that over 40% of pension schemes that rated the quality of advice as either good or very good had an underperforming manager. This suggested that at many schemes the perception of the consultants' advice is not driven by fund manager performance. An indication of whether good advice results in better manager selections can be seen using the binomial score. A comparison of the quality of the shortlist as measured by this score with the proportion of selected managers that either underperformed or outperformed the objective since appointment was made.

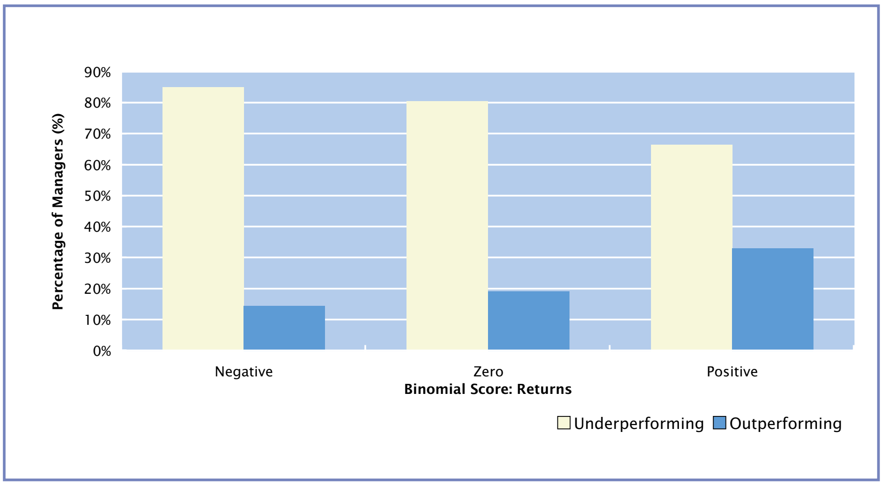


Chart 8.5.1: Impact of quality of advice on subsequent manager performance

As can be seen in Chart 8.5.1 there is an increase in the number outperforming and a decrease in the number underperforming as the quality of advice improves.

To highlight the differences between these proportions, we have represented Chart 8.5.1 relative to the expected proportion evident in Chart 3.4.1 for traditional asset classes. The results of this are presented in Chart 8.5.2. This provides a clearer indication of the impact of the quality of advice.

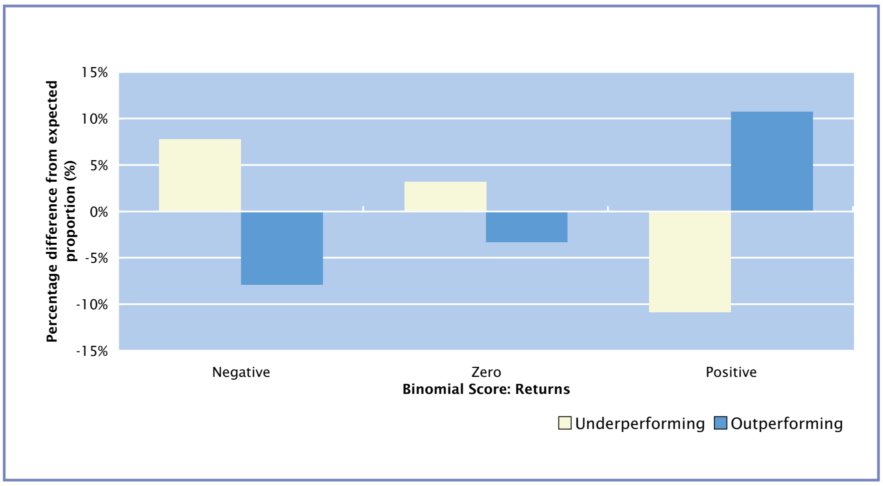


Chart 8.5.2 Impact of quality of advice on subsequent manager performance

Where manager selection advice was positive under the binomial score the proportion of outperforming managers selected increased by over 10%.

In Chart 8.5.2 it can be seen that those shortlists that produced a negative or zero rated score using the binomial methodology resulted in an increase in the proportion of underperforming managers chosen and a fall in the number of outperforming managers appointed. This result was more extreme for negative binomial scores where the move away from outperforming managers towards underperforming managers was 9%. Where manager selection advice was positive under the binomial score the proportion of outperforming managers selected increased by over 10%.

These results illustrate the potential value to a pension scheme of good manager selection advice. Selecting a manager that outperforms can add significant additional returns to the fund with consequent long term benefits to the funding requirement. The trend seen above suggests that when a pension scheme receives poor advice it is more likely they will have an underperforming manager. It is perhaps surprising therefore that at many schemes when a manager is changed for underperformance the trustees proceed with the same adviser to select the replacement manager. Good governance should dictate that before taking this action the effectiveness of the original advice is looked at.

8.6 **Key Points**

Value Added over time

- The results observed are consistent with the view that consultants are able to identify skilful fund managers.
- As time progresses, the value added by consultants increases. This effect is observed in each of the measurement approaches focusing on return.
- The opportunity for consultants to add value by selecting managers with superior risk management is negligible.

Value Added by Asset Class

- Shortlists for equity and property mandate selections generally provide more value added in selecting outperforming fund managers than those for bond mandates.

Other key points

- The quality of consultant advice is consistent across schemes of all sizes with no bias towards larger schemes.
- Where the manager selection advice has added value the proportion of outperforming managers increased by over 10% but fell by 9% when the advice was poor.

Section 9 : Effectiveness of the final decision

9.0 Final Decision versus shortlist

The final selection of the fund manager or managers from the shortlist rests with the trustees. In many cases the trustees carry out this task themselves often following advice from their investment committee but at some funds this decision is wholly delegated to the investment committee or the investment consultant. Where the decision is taken by the trustees or the investment committee they invariably rely on advice from their investment consultant to take that decision.

We would suggest that in choosing fund managers there are two broad approaches taken by pension schemes.

Firstly, trustee boards are seeking to select the manager they believe will provide the best performance for their fund from the shortlist. Additional considerations regarding the 'fit' of the manager with existing scheme managers may also be taken into account, for example in terms of the style or risk profile of the manager. However, it is reasonable for trustees to assume that on most occasions the shortlist will only include appropriate managers.

Secondly, trustee boards may expect that the investment consultant has put forward a shortlist of managers each of whom is expected to beat the funds objective in the future. In such circumstances the trustee board tends to regard their role as selecting an organisation they feel will be the most comfortable to work with and not attempting to select the one they believe will have the best performance.

The analysis in this section seeks to assess the decision-making of trustees in terms of the performance of the selected manager. This is congruent with the first of these approaches.

The analysis in this section seeks to assess the decision-making of trustees in terms of the performance of the selected manager.

9.1.1 The influence of Past Performance

Before examining whether trustees exhibit skill in selecting fund managers the importance of past performance in their decisions was considered. Section 6 illustrated that consultant shortlists contain a disproportionate number of top or second quartile fund managers. We suggested that one reason for this could be that consultants perceive that trustees regard this as a major factor in choosing a fund manager.

If the work of Ambachtsheer & Ezra is to believed then past performance should play no part in the decision to select a fund manager. In their book 'Pension scheme Excellence' they state that:

"Some fiduciaries like to select active managers by running statistical tests on past performance. The best fiduciaries know that this is futile. They know they are buying future performance, not past performance."

How important is past performance to trustees in selecting fund managers?

Chart 9.1.1.1 shows the performance record of those fund managers selected by trustees in the three and five years prior to selection. Over 80% of those selected had a five year track record in the top or second quartile prior to the selection process. More than 50% were top quartile.

Section Nine

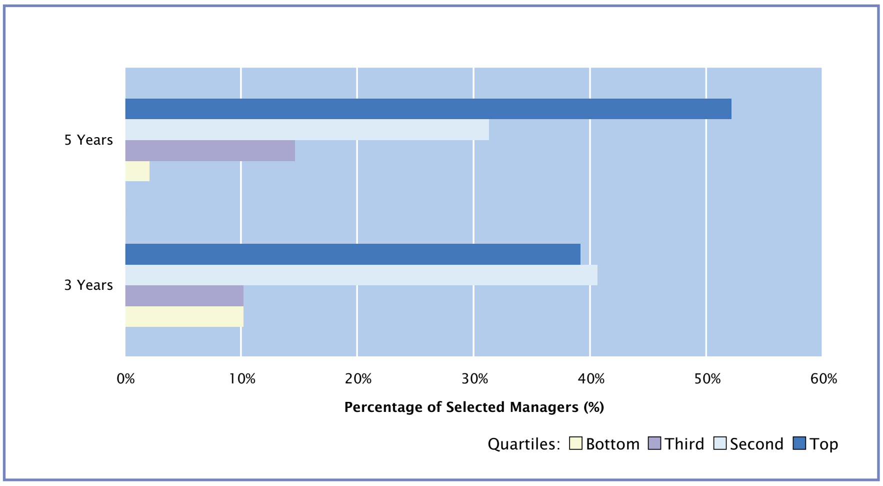


Chart 9.1.1.1: Past Performance: Percentage of selected equity managers in each quartile based on 3 year and 5 year performance prior to selection

It is quite possible that the bias towards top and second quartile manager is even greater than it appears here. The past performance shown is based on the house track record. It is therefore not possible to identify instances where a 'star' manager has changed firm and is immediately put forward on beauty parades as part of the investment team at the new firm. In such circumstances it is not unusual to present the manager's track record from the previous firm at the beauty parade. Consequently, the track record observed here may well be in the third or fourth quartile over three or five years but the record presented at the beauty parade may have been top or second quartile.

In order to understand the extent of any past performance bias by trustees in the final decision it is necessary to compare the outcomes presented in Chart 9.1.1.1 with the number of managers in each quartile on the shortlist. If past performance were not an issue for trustees the distribution for the trustees' final decision would be the same as the distribution of past performance of shortlisted managers. Chart 6.2.1 illustrated that 48% of consultant recommendations were top quartile and 32% second quartile for the five years prior to selection. How different are the final selections to the quartile distribution of consultant's recommendations?

Chart 9.1.1.2 shows the proportion of the final selections that are in the various performance quartiles compared to the number of shortlist recommendations made by consultants in each performance quartile.

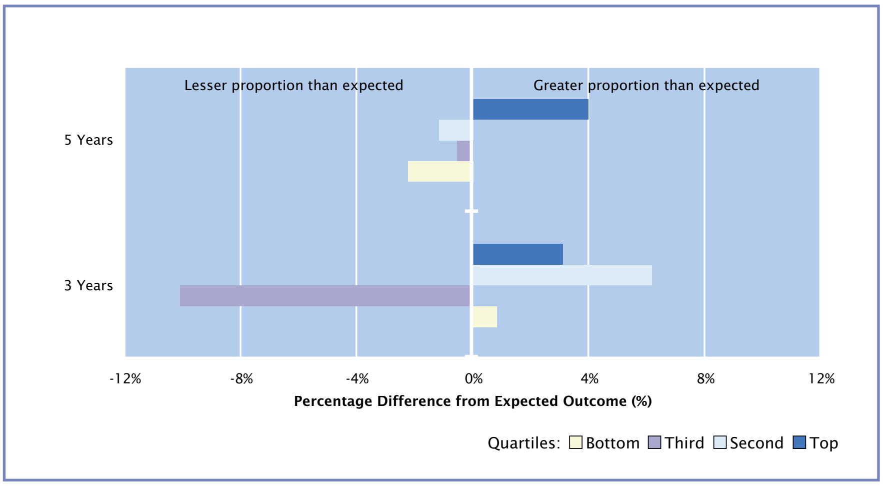


Chart 9.1.1.2 Past Performance: Percentage of selected equity managers in each quartile relative to recommended managers on the shortlists

Trustees have no clear bias towards managers with stronger past performance records.

This chart shows that the selection of manager by trustees is broadly in line with the number of managers on the shortlist in each quartile.

This suggests that trustees have no clear bias towards managers with stronger past performance records.

9.2 Value Added in the final decision

In many instances trustees are seeking to select the best performing manager in terms of performance for their fund. Therefore, it is reasonable to measure their effectiveness, in most cases, in terms of the subsequent performance of the selected manager.

If the performance of the manager is better than the shortlist median it is regarded as a positive decision.

To analyse whether trustees exhibit skill in selecting fund managers it is important to remember that their possible choices are limited to those managers on the shortlist and not the full universe of managers. In order to determine whether there is evidence of skill, the final selection is compared with the shortlist of managers presented to the trustees. If the performance of the manager is better than the shortlist median it is regarded as a positive decision. For those shortlists with an odd number of managers a selection of the median manager is defined as neutral. Neutral outcomes, which occurred in 28% of the manager selections, have been removed from the analysis. We are then left only with outcomes that are either a positive or negative. If trustees in aggregate have no skill in selecting fund managers 50% of these outcomes would be positive and 50% negative.

As can be seen from Chart 9.2.1, 58% of decisions were negative and 42% positive demonstrating that in the final decision the result is worse than would be expected from a random selection.

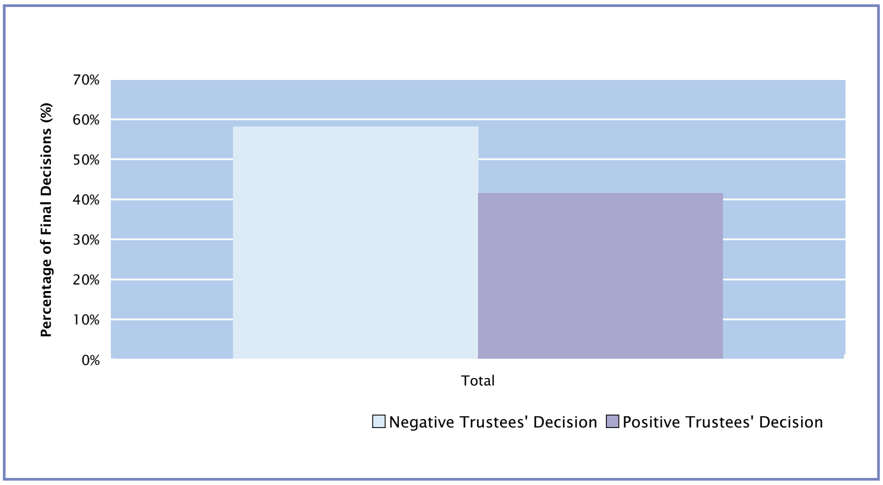


Chart 9.2.1: Final Selection – Positive versus negative decisions

Perhaps we should not be surprised at this outcome when it is considered how much information trustees are now required to learn. Even if trustees could learn all the information required to effectively select fund managers it should be remembered that judgement is not solely dependent on knowledge but also experience. Assessing fund managers is a complex and subtle discipline. Multi-manager firms that dedicate substantial resources and all their time to the selection of fund managers do not always manage to get it right. Trustees are required to select managers infrequently so have little opportunity to develop experience in this discipline.

9.3 Influence of final decision on subsequent performance of selected manager

Positive selection decisions result in a 24% increase in the probability of selecting an outperforming manager.

Chart 9.3.1 plots the change in the probability of selecting an outperforming manager as a result of a positive or negative decision. As can be seen positive selection decisions result in a 24% increase in the probability of selecting an outperforming manager whilst negative selection decisions result in a 17% reduction in the probability of selecting such a manager. Clearly, understanding how effective the trustees have been in their decision-making is critical for pension schemes seeking to enhance their performance. Several factors may have an influence on the quality of decision made by the trustees. Which of these are most material and which could be most easily adopted by pension schemes?

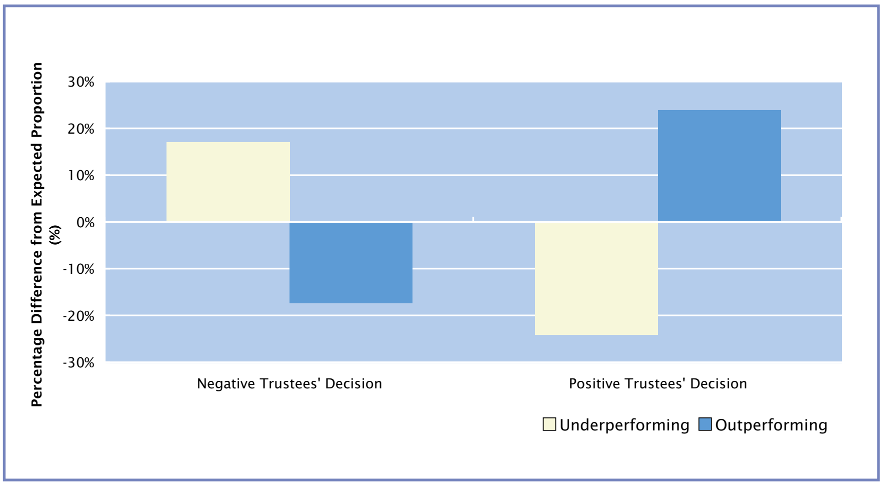


Chart 9.3.1: Relationship between the final decision and subsequent manager performance

9.4 Influence of fund size on final decision

The perception that larger pension schemes have significantly greater resources to manage their pension schemes is widely held and was illustrated by Goyal & Wahal. Large schemes are consequently able to recruit more experienced and knowledgeable trustees. It therefore follows that they may be able to achieve better quality decisions than smaller schemes. Is there any evidence? To investigate this, the sample has been separated into large and small schemes and success rates of the final decision compared.

Large schemes do appear to be more successful in their decision-making when choosing fund managers.

Chart 9.4.1 shows that large schemes do appear to be more successful in their decision-making when choosing fund managers. This suggests that the greater resources of large schemes do provide them with an advantage over smaller schemes. Whilst the result is interesting it is not particularly helpful for smaller schemes since they cannot change their size to enhance decision-making. It is possible for them to increase their budget for managing the pension scheme but this would ultimately have to be paid for from the fund and would not be an attractive option for most pension schemes. How can decision-making be improved without incurring significant extra cost?

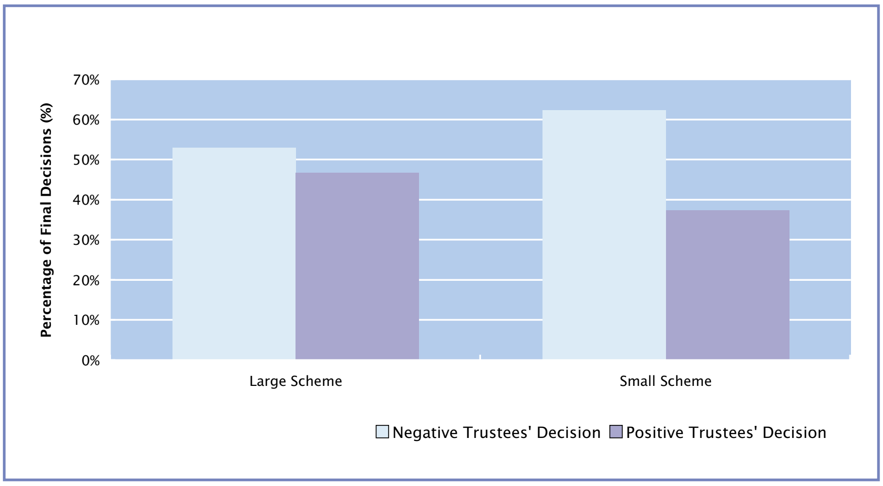


Chart 9.4.1: Final decision by Large and Small Schemes

9.5 Investment Committees versus Trustee Boards

A recommendation of the Myners Report was that trustees could enhance their investment decision-making by delegating these decisions to an investment committee. In order to determine if this improves the quality of decision-making, decisions taken by investment committees were compared to decisions taken by trustee boards. Again neutral decisions have been removed.

There is a significant increase in the proportion of positive decisions when investment committees chose the fund manager.

Chart 9.5.1 shows the number of positive and negative decisions. The results are striking. There is a significant increase in the proportion of positive decisions when investment committees chose the fund manager. 67% result in a successful selection where an investment committee is involved compared with only a 25% success rate where the decision was taken by the full trustee board.

Investment committees provide a resource efficiency for pension schemes and enable a higher level of knowledge to be built up by committee members than would be expected of an ordinary trustee. This improved knowledge appears to lead to a significant improvement in manager selection decisions with a consequential improvement in fund performance at many pension schemes.

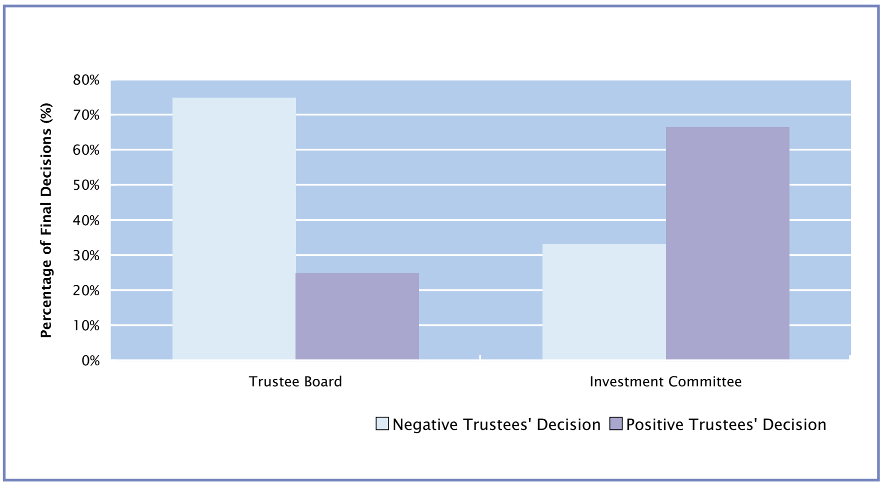


Chart 9.5.1 Trustee boards v Investment committees - final decision

9.6 Investment Committee Recommendations

Some trustee boards prefer to retain the final decision. Instead of delegating the final decision to the investment committee they may seek a recommendation from them or the investment consultant on which manager to appoint. Information on the parties making recommendations is given in Section 4. However whether these recommendations were followed is unknown.

The recommendations from either the investment committee or consultant do not appear to improve the decision-making of trustee boards.

Chart 9.6.1 compares the number of positive decisions by trustee boards that took a recommendation from their investment committee or investment consultant with positive decisions by trustee boards that had no recommendation. Perhaps surprisingly, given the previous result where investment committees take the decision, the recommendations from either the investment committee or consultant do not appear to improve the decision-making of trustee boards.

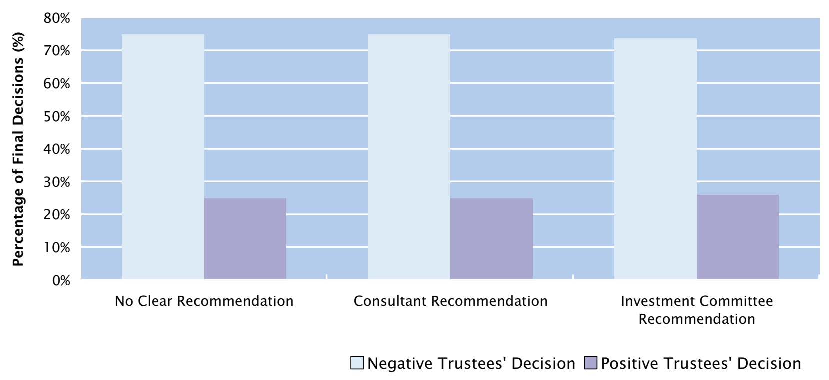


Chart 9.6.1: Trustee Board Decision without recommendations and with recommendations from Investment Committees and Consultants.

9.7 Key Points

- Over 80% of those managers selected by trustees had a five year track record in the top or second quartile. However, this is broadly inline with the number of managers on the shortlist in each quartile. There is therefore no clear bias towards managers with stronger past performance track records.

- Large schemes have an advantage in their decision-making when choosing fund managers compared to small schemes.

- The proportion of positive decisions increased significantly when investment committees chose the fund manager.

- Manager selection recommendations from investment committees to trustee boards do not appear to help the decision-making of trustee boards.

- Positive selection decisions result in a 24% increase in the probability of selecting an outperforming manager.

Section 10 : Conclusion

10.1 Consultant Advice

The survey has indicated that consultants are able to select skilful managers capable of outperforming over the longer term.

The survey has indicated that consultants are able to select skilful managers capable of outperforming over the longer term. In the early years, a wide spread of results is observed with the median observation close to zero. This may partly be explained by the difficulty in identifying fund manager skills from short term performance. However as time extends the benefit of this skill becomes more evident. Within this result the selection of equity and property managers appears to add more value than the selection of bond managers.

There are benefits to be gained from receiving good quality advice regarding the manager selection process. Chart 10.1.1 is reproduced from Section 8 and shows the relationship between the quality of advice (as measured by the binomial methodology) and the subsequent performance of the selected manager.

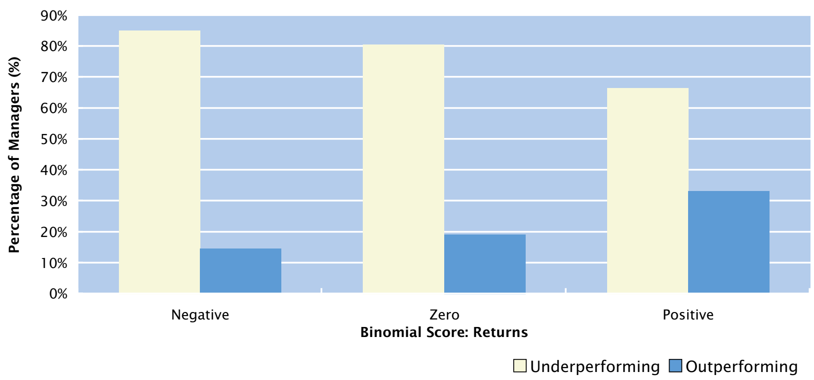


Chart 10.1.1: Impact of positive advice on the final selection process

With good quality advice the probability of selecting an outperforming manager is increased to 33% compared to 15% if the advice is poor.

With good quality advice the probability of selecting an outperforming manager is increased to 33% compared to 15% if the advice is poor. However, there is a significant proportion of neutral and poor advice provided to pension schemes and it is important for trustees to consider how they can increase the likelihood of receiving good advice.

A first step to improving advice is to understand how effective previous advice has been. This is certainly important before embarking on a new manager selection process. However, as the consultant will invariably be involved in the monitoring of a schemes fund managers it is clearly helpful for the trustees to be aware of the effectiveness of the advice they have received in the past. The Myners Report and recent NAPF guides on the measurement of consultant's advice have highlighted the importance of independently measuring the effectiveness of a scheme's investment consultant.

Knowing how effective the advice has been is only part of the picture. Trustees should also seek to understand how their investment consultant is carrying out their manager research in the same way they endeavour to understand their scheme's investment managers' philosophy and style. Factors such as the resources devoted to manager search, the consultant's track record in this area, the key drivers in their manager selection and the importance of past performance to the final decision should all be considered.

Furthermore the work of The WM Company and Goyal & Wahal has suggested that the selection of managers with strong recent performance track records leads to disappointment. We have observe that a disproportionately large number of recommended fund managers have a top quartile record. If the trends identified by The WM Company and Goyal & Wahal persist, then the effectiveness of shortlists can potentially be improved if approaches can be found to reduce the importance of past performance.

10.2 Trustees' Decision

In Section 9 the effectiveness of trustees' decisions was shown to be positive in 42% and negative in 58% of the selections analysed. However, we have observed areas of best practice which can increase the probability of making a positive decision.

The most significant way in which the probability of success can be improved is by delegating the selection of fund managers to an investment committee.

The most significant way in which the probability of success can be improved is by delegating the selection of fund managers to an investment committee. The extra specialisation an investment committee brings appears to reap real rewards for pension schemes in terms not only of the quality of investment decisions but also in effective use of available resources.

Feedback on the effectiveness of any decision-making process is important if the process is to be improved. This is as true for pension schemes as any other part of their sponsor's business. Consequently, regular monitoring of decisions should, over time, lead to an improvement in the decision-making process.

In the previous section we saw the benefits of positive selections on the subsequent performance of the selected fund manager. Chart 10.2.1 is reproduced from Section 9.

As can be seen positive selections from the shortlists improves the probability of subsequent outperformance from the selected manager by over 20%.

As can be seen positive selections from the shortlists improves the probability of subsequent outperformance from the selected manager by over 20%.

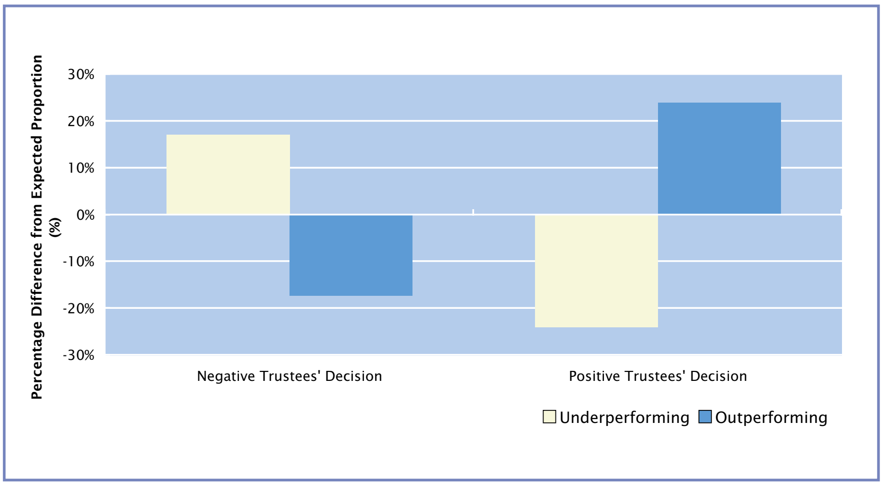


Chart 10.2.1: Relationship between positive decisions and the subsequent performance of fund managers

Section Ten

10.3 Combined effect of positive advice and positive final selection

The effects of good quality advice and positive selections from the shortlist have been shown separately to substantially improve the probability of selecting fund managers that outperform. The objective for schemes in carrying out a manager selection must be to ensure they have good quality advice and make a positive selection from the shortlist. Chart 10.3.1 shows the impact of getting both elements correct.

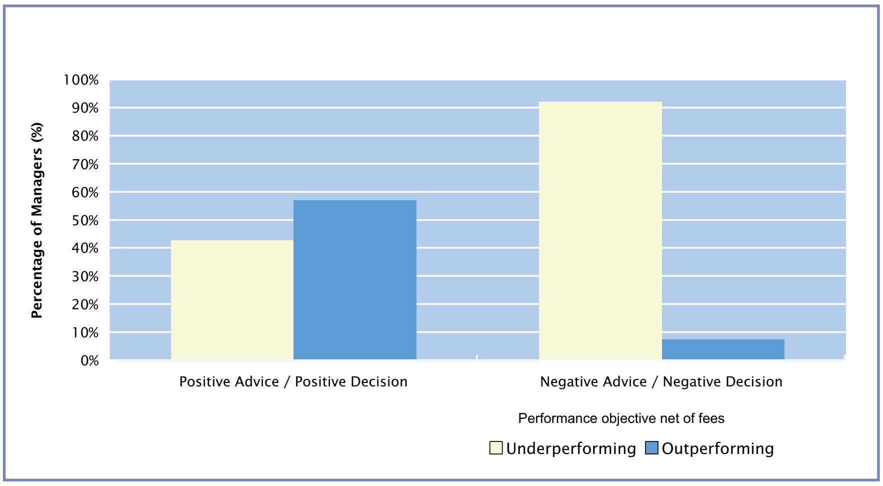


Chart 10.3.1: Impact of positive advice and decisions on the final selection

The combination of positive advice and decisions in choosing the fund manager from the shortlist improves the probability of selecting a manager that outperforms the objective from 8% to 57%.

The combination of positive advice and decisions in choosing the fund manager from the shortlist improves the probability of selecting a manager that outperforms the objective from 8% to 57%. The benefits to pension schemes from seeking to understand and improve their decision-making processes are clearly substantial. Resources committed to this area are likely to be well rewarded.

It should be noted that the current manager selection process with positive advice and a positive selection still only leads to a 57% chance of selecting a manager that will achieve the mandate objective. A possible explanation for this low success rate is that the performance objectives being set are too demanding for fund managers. As a result, pension scheme trustees often seem to regard the outperformance of the benchmark net of fees, as a measure of success, rather than the objective. Chart 10.3.2 compares the impact of positive advice and decisions with performance against the benchmark.

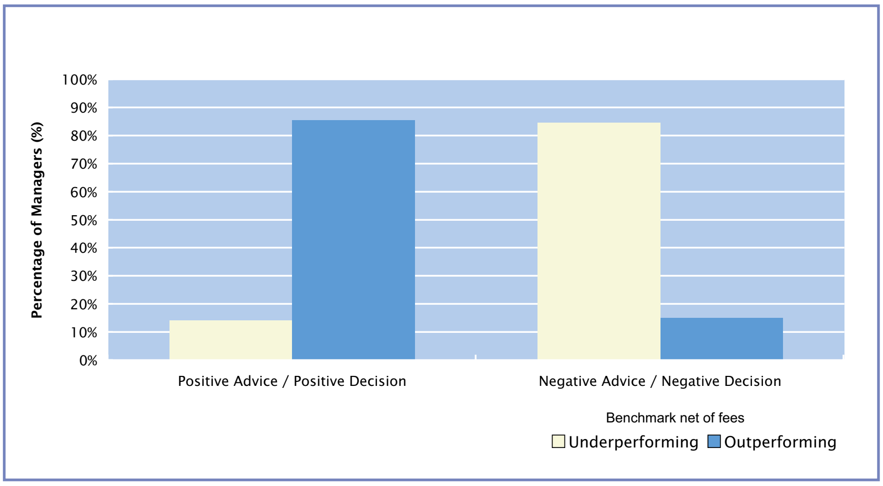


Chart 10.3.2: Impact of positive advice and decisions on the final decision measure against the Benchmark net of fees

The combination of positive advice and a positive selection decision almost guarantees they achieve this with 86% of all selections resulting in outperformance against the benchmark.

If the first hurdle for pension schemes is to outperform the benchmark then the combination of positive advice and a positive selection decision almost guarantees they achieve this with 86% of all selections resulting in outperformance against the benchmark. On the other hand the combination of negative advice and a negative selection decision results in an almost mirror image of this result with 85% of selections underperforming.

The gain to pension schemes from receiving the best advice and ensuring their trustees or investment committee members are equipped with the knowledge and skills to take appropriate decisions are substantial. To ensure they are in a position to achieve this, as the Myners Report suggested, resources should be committed to the measurement and monitoring of their investment consultant's advice and trustees' decisions. This would provide feedback on the effectiveness of the current decision-making process and highlight areas where improvements can be made.

Section Ten

Appendix I: Performance Universe - Fund Managers

Many of the measures employed in this report analyse the quality of shortlists and the effectiveness of the final decision in selecting the fund manager. These measures are based on a performance universe of relevant GIPS compliant track records for the fund managers both on the shortlist and those offering similar products to institutional investors. These track records have been obtained from Mellon Analytics AMI and Pooled fund databases and are supplemented with information obtained directly from fund managers. Included in these universes are fund managers who have been acquired by or merged with other firms over the last 5 years. Where appropriate, the performance of these managers has been linked to the track records of the acquiring manager for the time period following the merger or acquisition.

The following fund managers have been included in the analysis universes (a complete list of universes can be found in Appendix II):

Abbey National Asset Managers
Aberdeen Asset Management
Aberforth Partners
ABN AMRO Asset Management
Acadian Asset Management
Advanced Investment Partners
Advisory Research
Aegon Asset Management
Affinity Investment Advisors
AIB Govett Asset Management
AIG Global Investment Group
AIM Trimark Investments
Allegiant Asset Management Company
Alliance Bernstein
Alta Capital Management
Ariel Capital Management
Arlington Property Investment Management
Aronson+Johnson+Ortiz
Arrowstreet Capital
Artemis Investment Management
Awad Asset Management
AXA Investment Managers
AXA Rosenberg Group
Babson Capital Management
Bahl & Gaynor
Baillie Gifford
Bank of Ireland Asset Management
Bank Of Tokyo-Mitsubishi
BankInvest Asset Management
Barclays Global Investors
Baring Asset Management
Bear Stearns Asset Management
BKF Asset Management
BlackRock
BNP Paribas Asset Management
Boston Partners Asset Management
Brandywine Asset Management
Bridgewater Associates
Britannic Asset Management
Brown Capital Management
Cambiar Investors
Capital Group International
Cazenove Capital Management
CB Richard Ellis
CCLA Investment Management
Chicago Asset Management Company
Citigroup Asset Management
Citizens Advisers
Clay Finlay
Clover Capital Management
Cohen, Klingenstein & Marks
Cornercap Investment Counsel
Credit Suisse Asset Management
Daruma Asset Management
Davis Hamilton Jackson & Associates
DekaBank
Deutsche Asset Management
Dexia Private Banking
DiAM - Degroof Institutional Asset Management
DLIBJ Asset Management USA
Driehaus Capital Management
Duncan-Hurst Capital Management
Eagle Asset Management
EARNEST Partners
Edinburgh Fund Managers
Enhanced Investment Technologies
Essex Investment Management Company
F&C Asset Management
Ferguson Wellman Capital Management
Fidelity
Fiduciary Asset Management
Fifth Third Asset Management
First Quadrant
First State Investments
Fischer Francis Trees & Watts
Fisher Investments
Fort Washington Investment Advisors
Fortis Investments
Framlington
Franklin Portfolio Associates
Franklin Templeton Institutional
Friess Associates
Frontier Capital Management Company
GAM
Gartmore Investment Management
GE Asset Management
Glasgow Investment Managers
GLG Partners
GMO
Goldman Sachs Asset Management
Gould Investment Partners
Greystone Managed Investments
Groupe CCR
Guardian
Guernsey International
Halifax Investment Fund Managers
Hanover Property
Harding, Loevner Management
Harris Associates
Henderson Global Investors
Hermes Investment Management
High Pointe Capital Management
Highstreet Asset Management
Hill Samuel
HSBC Asset Mangement
Hunter Property Fund Management
ING Investment Management
Insight Investment Management
Institutional Capital Corporation
INVESCO Asset Management
Investec Asset Management

Investment Solutions Limited
InView Investment Management
Janus Capital Management
Jensen Investment Management
JPMorgan Asset Management
Julius Baer Asset Management
Jupiter Asset Management
KBC Asset Management
Laffer Investments
Langbourn Property Investment Services
Lazard Asset Management
Legal & General Investment Management
Legg Mason Capital Management
Liontrust Asset Management
Lloyd George Management
Lombard Odier Darier Hentsch
Loomis Sayles & Company
Los Angeles Capital Management
Lothbury Property Trust
Lotsoff Capital Management
LSV Asset Management
Majedie Asset Management
Maple-Brown Abbott
Marathon Asset Management
Martin Currie Investment Management
Martingale Asset Management
Marvin & Palmer
Mawer Investment Management
McKinley Capital Management
Mellon Capital Management
Merrill Lynch Investment Managers
Metropolitan West Asset Management
MFS Investment Management
MindShare Capital Management
MIRABAUD Investment Mangement
Mondrian Investment Partners
Morgan Stanley Investment Management
Morley Fund Management
Neptune Investment Management
New Amsterdam Partners
New Century Investment Management
New Star Asset Management
Newton Investment Management
Nicholas-Applegate Capital Management
Nomura Asset Management
Nordea Investment Management
Northern Trust Global Investments
NorthPointe Capital
Oberweis Asset Management
OFI Institutional Asset Management
Old Mutual Asset Managers
Oppenheimer Capital
Orbis Investment Management
Payden & Rygel Investment Management
Penn Capital Management Company
Perennial Investment Partners
Pictet Asset Management
PIMCO
Pioneer Global Asset Management
Principal Global Investors
Protego Real Estate Investors
Provident Investment Counsel
Prudential M&G
Putnam Investments
Pyrford International
Rainier Investment Management
RCM (UK) Ltd
Rice Hall James & Associates
Rogge Global Partners
Roll and Ross Asset Management
Roxbury Capital Management
Royal London Asset Management
RS Investment Management
Russell
SAM Sustainable Asset Management
Sarasin Investment Management
Schroder Investment Management
Scottish Widows Investment Partnership
SEB Asset Management
Setanta Asset Management
SG Asset Management
Singer & Friedlander
Sound Shore Management
Sovereign Asset Management
SPARX Asset Management
Standard Life Investments
State Street Global Advisors
SVM Investments
Swiss Life Asset Management
T. Rowe Price
TCW Group
Teesland iOG
The Boston Company Asset Management
Threadneedle Asset Management
Tilney Investment Management
Trilogy Global Advisors
TT International Investment Management
UBS Global Asset Management
Union PanAgora Asset Management
Vontobel Asset Management
Waddell & Reed Investment Management Company
Wall Street Associates
Walter Scott & Partners
Weiss, Peck & Greer
Wellington Management
Western Asset Management
Westpeak Global Advisors

Appendix II: Performance Universe – Classification

The fund manager's GIPS composite returns have been classified into several different performance universes that match the mandate types of shortlists recommended by investment consultants. The following universes have been used in our analysis with separate universes constructed for the analysis of segregated and pooled mandates:

UK Equity Core

UK Equity Growth

UK Equity Value

UK Small Cap Equity

Global Equity Core

Global Equity Growth

Global Equity Value

European Equity Core

North American Equity Core

North American Small Cap Equity

Pacific Basin Equity

UK Government Bonds

UK Non-Government Bonds

UK Government & Non-Government Bonds

UK Index Linked Bonds

UK Government, Non-Government & Index Linked Bonds

Global Bonds

Multi-Asset excluding Property

Multi-Asset including Property

UK Property

Appendix III: Bibliography

Ambachtsheer, Keith P. and D. Don Ezra *Pension scheme Excellence.*

Goyal, Amit and Sunil Wahal, Goizueta Business School May 2005 *The Selection and Termination of Investment Management Firms by Plan Sponsors.*

Hogarth, Robin *Judgement and Choice (Second Edition).*

Instinet (Research undertaken by rd:ir) September 2004 *Taking the Temperature of the UK pension scheme Industry, Second Edition.*

Kahneman, Daniel, Paul Slovic and Amos Tversky (edited by) *Judgement under uncertainty: Heuristics and biases.*

Myners, Paul March 2001 *Institutional Investment in the United Kingdom: A Review.*

NAPF March 2005 *Trustees' relationships with their investment consultants and advisers.*

NAPF March 2006 *Trustees' Self-assessment of their Performance and Assessment of their Third Party Providers.*

Treasury, HM December 2004 *Myners principles for institutional investment decision-making: review of progress.*

WM Company July 1996 *Does changing manager improve performance?*

WM Company August 1998 *Does changing manager improve performance?: an update.*

WM Company October 2001 *Does changing manager improve performance?: latest evidence.*

WM Company November 2005 *The performance effect of changing manager.*

Fund Manager Selection Survey Report 2006 – Part 2 (Consultant Effectiveness)

The Fund Manager Selection Survey Report 2006 is published in two parts. Part 1 provides a general overview of the effectiveness of the manager selection process. Part 2 reviews in more detail the performance of each of the UK's major investment consultants in recommending fund managers. To get the complete picture, contact Blacket Research or visit our website at www.blacketresearch.co.uk.

About Blacket Research

Blacket Research helps pension schemes measure the quality of the advice they receive from their investment consultants so that trustee boards, pension managers and finance directors can improve their decision-making, fund performance, and scheme governance.

We have developed new evaluation methodologies for each stage of the investment process that is directly influenced by the investment consultant's advice. These methodologies are already being used to provide assessment to major pension schemes.

Most importantly, we are independent and free of potential conflicts of interest when dealing with pension schemes and their advisers.

Other Services

Manager Selection Evaluation

Provides a detailed and quantitative analysis and report that measures and monitors the quality of the investment consultant's advice in recommending fund managers.

Strategic Evaluation

Enables companies to understand the potential impact of their strategic decisions on the company's accounts, provides benchmarks against other defined benefit pension schemes and improves trustee's understanding of the strategic risk in the pension scheme.

For full details, visit us at www.blacketresearch.co.uk

blacket
research limited

Appendix III

IC Select Fiduciary Management Performance Standard

IC SELECT – FIDUCIARY MANAGEMENT PERFORMANCE STANDARD

INTRODUCTION

IC Select Composite Construction and calculation methodology
As with other types of investment management performance presentation, the formation of composites should form the basis of any performance standard.

Compliance with a composite approach requires every pension fund managed on a fiduciary basis to be placed in a composite. Composites should be constructed based on funds that have similar return objectives, risk tolerances and hedging constraints rather than identical benchmarks.

The construction of a fiduciary manager firm's composites is entirely at the discretion of the fiduciary manager firm.

Once the composites are constructed, a document should be maintained listing all composites, their objectives, risk parameters and hedging constraints, the number of firms in the composite, the assets under management and the date the composite was first constructed. Any pension fund carrying out a fiduciary manager selection exercise can then examine this list to understand whether the performance record being presented is the most appropriate or to agree the composite data that will be used for the purposes of their selection process. Consequently, the decision about which track record is used has effectively been passed from the fiduciary manager to the pension scheme or their advisers.

Performance Information
Performance calculation should be based on the return relative to the benchmark net of fees. It is considered that for most schemes the benchmark will either be the liabilities, on either a gilts or swaps basis, or some fixed asset split with a hedging constraint. Where the benchmark is a fixed asset split it will also be necessary to record how the performance of that fund, net of fees, is expected to compare to the liabilities (e.g. liabilities plus 2%) with performance measured against liabilities.

Risk information
It is considered that one of the main benefits of fiduciary management is an improvement in risk management relative to the liabilities. There are two types of risk metric that are currently considered relevant, variability of returns and downside risk.

Using a risk measure of variability of returns, based on relative performance net of all fees, could understate risk and enhance the apparent risk management of organisations charging high performance fees. Consequently, the measure of volatility that is considered most appropriate is the tracking error based on relative returns net of trading and other costs but before deduction of the fiduciary manager's fees and any sub-adviser fees.

Maximum drawdown is the preferred measure of downside risk.

Presentation of performance data
In any tender document, the approach to displaying performance information in the body of the document will be determined by the fiduciary management firm. However, an appendix must be included setting out the performance information in a standard format that shows the performance history from the inception of the composite. A further appendix should be included showing the full list of a firm's composites. By displaying the information in a standardised format in an appendix, any issues relating to the time period or presentation of information can be avoided.

Data frequency
Performance data should be calculated on a monthly basis.

Data Submission for audit purposes
Data should be submitted to IC Select using the attached spreadsheet format. A separate spreadsheet should be included for each composite and umbrella composite together with a list of all composites in the format also shown in the attached spreadsheet.

Information submitted to IC Select should be updated six monthly starting from.

Establishment of composites
Once the initial data is collected an analysis of the composites produced by each firm will be completed. For example, the correlation between each of the composites of a firm and across firms and the dispersion of composites will be considered. This information will then be circulated in anonymised form to each of the firms submitting data to allow firms to develop an understanding of how their composite construction compares with that of other firms. The information is designed to assist each firm review their composites and, if considered appropriate, to amend them. There will be a period during which composites can be amended before the construction of composites becomes final.

Timetable for the establishment of composites
To be added

Audit of IC Select Composites
Firms will not be required to have their composites externally audited. Instead IC Select will, at their expense, audit compliance with the standards. It is expected that this audit will be no more frequently than annually.

Steering Group
The development of the IC Select Performance Standard is guided by a steering group comprised of:

Peter Dorward (Chair)	Managing Director	IC Select
Roger Brown	Founder and Director	IC Select
David Clare	Partner	Barnett Waddingham
David Felder	Director	Law Debenture
Mark Latimour	Partner	Eversheds
Kevin LeGrand	President	PMI
Iain McAra	Director GIPS EMEA Region	CFA Institute
Neil Mcpherson	Managing Director	Capital Cranfield
Giles Payne	Director	HR Trustees
Colin Richardson	Client Director	PTL Ltd
James Trask	Senior Partner	LCP
Graham Wardle	Managing Director	Bestrustees
Anthony Webb	Head of FM Advisory	KPMG

Copyright
IC Select has copyrighted this approach to standardising fiduciary management performance. IC Select do not intend to charge for the use of this intellectual property. However, where this performance approach is used, fiduciary managers and other organisations presenting the data will have to highlight IC Select's intellectual property.

Where data is presented within a report, either in numerical or chart form, it should carry the disclosure as: "Source: XYZ, IC Select FM Performance Standard"

3 January 2017

IC SELECT – FIDUCIARY MANAGEMENT PERFORMANCE STANDARD

GUIDELINES

1. **General**
   1.1. All requirements should be complied with and, if not, this should be noted where compliance is not met.
   1.2. The performance standard should be applied to all fiduciary management clients of a firm
   1.3. A full list of composite descriptions should be maintained. This must show the composite name, description, creation date, start date, end date (for terminated composites) and the current number of schemes in the composite. Terminated composites should be maintained on the list for at least three years.
   1.4. Historical composite performance should not be altered following a change in the organisation of the firm. However, any such change or changes affecting the team managing a composite must be highlighted including the date that any change took place.
   1.5. Performance data should be updated quarterly.

2. **Performance Calculation**
   2.1. Returns must be shown relative to the benchmark. Any objective (e.g. benchmark + X%) should be ignored in the calculation of relative returns.
   2.2. Returns relative to benchmark should be calculated on three bases for each scheme:
      2.2.1. NET of all charges, **including** performance fees, and base fees for both the fiduciary manager and any sub-advisors.
      2.2.2. NET of sub-advisor charges and fiduciary manager base fees but **excluding** fiduciary manager performance fees.
      2.2.3. GROSS of all fiduciary manager charges and sub-advisor charges.
   2.3. Time weighted returns must be used. Periodic and sub-periodic returns must be geometrically linked.
   2.4. Scheme returns must be calculated at least monthly.
   2.5. Return calculations must include returns from cash and cash equivalents held in the schemes.
   2.6. Returns must be calculated after the deduction of all trading and other related expenses
   2.7. Composite returns must be calculated by equally weighting the individual scheme returns on each of the three bases above (see 2.2) relative to their benchmark.
   2.8. Returns should not be annualised for part year returns.
   2.9. Returns should be calculated net of non-reclaimable withholding taxes on dividends, interest and capital gains.
   2.10. Where a client has restricted the level of interest rate hedging it is suggested that the benchmark includes cash for the proportion where interest rate hedging is not allowed and the liabilities for the proportion of liabilities where hedging is allowed. This reflects the client's responsibility for the decision to limit hedging on a proportion of the liabilities.

3. **Fiduciary Management Composite Construction**
   3.1. All schemes managed by the fiduciary manager must be included in at least one composite.
   3.2. Only actual schemes can be included in composites
   3.3. Simulated or model schemes must not be linked with actual pension fund data.
   3.4. Each firm must decide on their composite definitions. Schemes should be included in the same composite where they are similar rather than identical. In deciding on the definitions of composites firms should consider, amongst other factors, the following:
      - The level of discretion (e.g. does the client have to be consulted before an investment is made)
      - The nature of the benchmark (e.g. liability, gilt or a specific asset mix)
      - Any hedge ratio restriction
      - Objective or risk (e.g. liability +3%)

- Size of the scheme

3.5. The use of umbrella composites to combine together similar sub-composites is encouraged although these should be clearly labelled.

3.6. Composites must include all schemes that meet the composite description.

3.7. After 31 December 2015 (the end of the set up period) any change to a composite must not be applied retrospectively.

3.8. The composite definition must be included with the data submission.

3.9. New schemes must be included in the appropriate composite once transition is completed and the fiduciary manager becomes responsible for performance.

3.10. Terminated schemes must be included in the historical record of the composite up to the last full month that the scheme was under management.

3.11. Schemes should not be switched between composites unless documented changes to the investment mandate make it appropriate. The historical record of the scheme must remain with the original composite.

3.12. Where a scheme is moved from one composite to another, for example as a result of de-risking, the scheme should be removed from all composites during the month or months in which the transition takes place. The performance record, up to the month of the transition must remain with the original composite. Performance following the end of the final transition month, will be included in the new composite.

4. Performance Presentation Required Information and Standard Format

Where performance is being presented as part of a tender managed by IC Select or if compliance with this standard is claimed then the following ***minimum*** *information presentation should be included for the most appropriate composite or composites as an appendix. Data can be included throughout the tender document or any presentation material with other presentation forms (e.g. charts):*
An example of the layout for a composite appendix is attached as an illustration. However, firms are encouraged to use their own layout if preferred to reflect their house style.

4.1. The currency for the composite must be disclosed.

4.2. A minimum of ten years' performance data should be presented or, if the composite inception is less than ten years ago, the period from the composite start date, should be presented.

4.3. Composite returns net of all fees (see 2.2.1) for each annual period must be presented.

4.4. Composite returns net of all fees (see 2.2.1) for the previous one, three, five, seven and ten year periods and since inception must be presented.

4.5. The maximum drawdown for the previous one, three, five, seven and ten year periods and since inception must be presented calculated as a percentage as being

> (Peak value in relative net of all fees (see 2.2.1) before largest drop - Lowest value in relative net of all fees (see 2.2.1) before a new high established)/Peak value in relative net of all fees (see 2.2.1) before largest drop.

4.6. The annualised ex-post standard deviation of monthly composite GROSS relative returns for the previous three, five, seven and ten year periods and since inception must be presented.

4.7. The information ratio (annualised NET relative return divided by annualised ex-post standard deviation of monthly composite GROSS relative returns) for the previous three, five, seven and ten year periods and since inception must be presented must be presented.

4.8. Three year annualised ex-post standard deviation of 36 monthly composite GROSS relative returns as at the end of each annual period must be presented.

4.9. Disclosure should be made if there is insufficient data to calculate three-year ex-post standard deviation of monthly composite returns.

4.10. If three year annualised ex-post standard deviation of composite returns is not used then an explanation should be provided as to why this is not relevant or appropriate and what alternative risk measure has been used.

4.11. The information ratio (three year annualised NET relative return divided by three year annualised ex-post standard deviation of 36 monthly composite GROSS relative returns) at the end of each annual period must be presented.

4.12. If a case study scheme is used as part of the tender document or presentation then the composite for this scheme must be provided. This should include the comparable measures for the case study scheme alongside its composite information.

Where there are four or more schemes in a composite, information should be provided on dispersion. For periods where there were four to nine schemes in the composite, the median, high and low should be shown. If there are ten or more schemes in a composite the median, high, low, 90 percentile and 10 percentile should be shown

4.13. If there are less than four schemes in a composite then the number of schemes in the composite should be disclosed as “less than four”.

4.14. Any change in the organisation of the firm affecting the team managing a composite must be highlighted including the date that any change took place.

4.15. Any material changes to valuation policies or methodologies should be disclosed.

4.16. Any material changes to calculation methodologies should be disclosed.

4.17. All performance summaries should have the note “XYZ has prepared and presented this report in compliance with the IC Select FM Performance Standards”

4.18. Where data is presented within a report, either in numerical or chart form, it should carry the disclosure as “Source: XYZ, IC Select FM Performance Standard”

IC Select Limited

IC SELECT
OVERSIGHT AND SELECTION SPECIALISTS

Example layout of information for inclusion as an appendix where performance data has been used as part of a submission

Sample Reporting Appendix Layout

Composite Name:
All funds with a return target close to liability plus 2% and with no hedging constraint

Composite Description
E.g. All funds with a return target between liability plus 1.5% and 2.5% with no hedging constraint

Report to 31 December 2016

Currency = Sterling

Net relative monthly returns					
Date	No of funds	Composite realtive return net of all fees %	Composite Asset Value	% Of firm	Total firm value of all composites
2016	9	0.70	1,209,361,816	6.31	19,165,797,401
2015	9	1.84	1,354,208,490	6.48	20,898,279,167
2014	7	3.62	2,158,777,509	6.39	33,783,685,587
2013	5	-1.47	2,376,390,223	7.01	33,900,003,181
2012	5	2.34	2,148,356,889	6.66	32,257,610,946
2011	4	-0.42	2,221,179,001	6.04	36,774,486,772
2010	2	-2.04	1,968,762,570	5.93	33,200,043,339
2009	2	1.28	2,599,135,439	6.12	42,469,533,317

Dispersion of net relative returns					
	Min	90th	Median	10th	Max
2016	0.26	0.35	0.84	1.41	2.13
2015	0.94	1.26	1.73	2.22	2.41
2014	2.04	2.76	3.55	4.44	5.26
2013	-2	-1.8	-1.4	-0.62	-0.13
2012	-0.13	1.48	2.15	2.59	3.01
2011	-1.83		-0.39		1.94
2010					
2009					

Composite net Annualised Relative return and downside risk measure		
Period	Net relative return	Maximum drawdown
YTD	0.7	-0.12
1 Year	0.7	-0.12
3 Year	2.05	-0.46
5 Year	1.39	-2.68
7 Year	0.65	-2.94
Since inception	0.73	-2.94

Annualised Risk Measures		
Period to end	36 month Tracking error (Gross excess return)	Information Ratio*
Current	3.6	0.31
2013	4.2	0.28
2012	4.5	0.21
2011	3.9	0.13
2010	4.1	-0.06
2009	3.8	-0.24

* Information ratio = 36 month annualised relative return net of all fees / 36month tracking error (Gross excess return)

Changes in firm organistation affecting mangement of composite

e.g. 1) Senior portfolio manager, A N Other, left on 14 June 2013

Note: XYZ has prepared and presented this report in compliance with the IC Select FM Performance Standards