

Thinking critically about investment manager reviews

February 2024

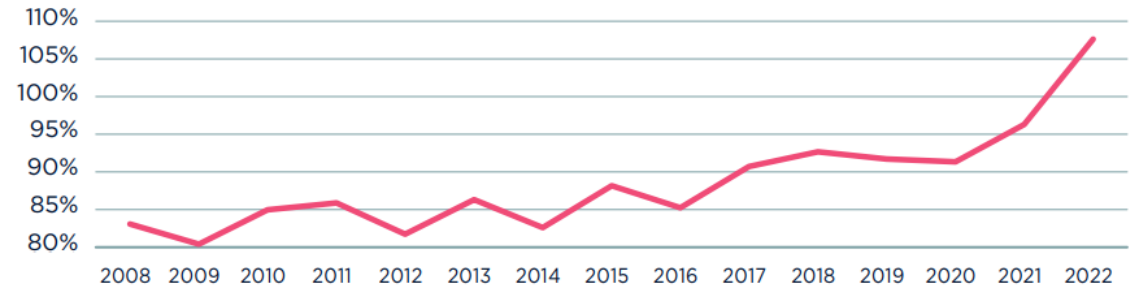
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What has changed over the past decade?

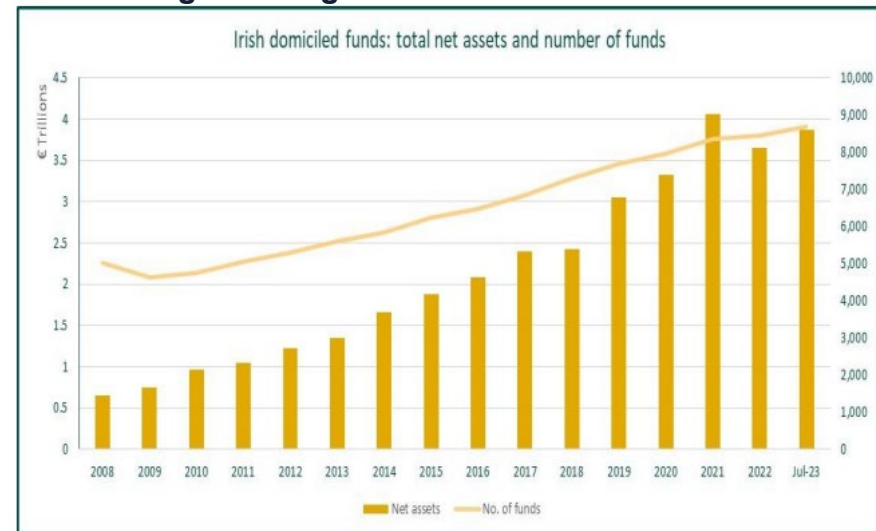
Let's start with DB Schemes....

- Funding position
- Endgame target
- Investment strategy
- The nature and scale of investment managers and the products they provide
- The composition of your Trustee board
- How your scheme interacts with its investment manager(s)

Average funding level (LCP Accounting for Pensions 2022)



Significant growth in Irish funds sector



Poll Question: When thinking about the largest pension scheme you are involved with, how long has the investment manager with the greatest proportion of the assets been in place?

Why do we have a requirement to conduct a critical review of investment managers?

Step Four

- It's a requirement under IORP II?
- To add yet another job to the list to already heavily burdened Trustees?
- To create more work for the pensions advisory industry?

OR

- To combat human behavioural bias?
- A sensible and practical alternative to mandated "retendering"?

What is the critical review requirement?

Extract from the Pension's Authority Code of Practice

- **What is a critical review? (Paragraph 87)**

*“A critical review is **an in-depth review of an investment service** conducted against the criteria that were first applied when appointing the investment manager, while also taking into account any modifications that were subsequently agreed upon during the course of the investment manager’s contract (for example, an additional passive investment mandate that was added to the original mandate). The **critical review forms the basis for a decision by the trustees as to whether to retain the current investment manager or consider their replacement.** A critical review does not automatically require that the trustees initiate a tender process. Such a process must be initiated, however, if **the performance assessment gives rise to substantial issues of concern, including concerns regarding value for money**”.*

- **Who should advise the Trustee on a critical review? (Paragraph 80)**

*“**When acquiring and considering information in relation to the appointment or retention of investment services, the trustees should consult with independent experts** to the extent that they require assistance with identifying potential investment managers, organising requests for proposal and interviews, understanding the capabilities of proposers, making comparisons, and analysing costs. Such assistance must be obtained, whenever possible; from **parties who do not have a direct conflict of interest in advising the trustees.**”*

What are the benefits of a critical review?

1 Improved **Trustee board understanding** of the role of the appointed investment manager(s).



2 **Value for money** from existing investment managers is assured



3 Puts in place a **clear process for reviewing** and potentially replacing underperforming managers



4 Potential **conflicts of interest are clarified** and therefore better managed going forward



Some recent case studies



Mid-sized DB scheme with significantly refreshed Trustee board



Large DB Scheme with significant active bond mandate



Mid-sized DB scheme with underperforming manager(s) and a relatively large number of managers and funds



DC scheme with poor performing and sub scale legacy fund options

What does a good critical review look like?



Review of investment capabilities

Is the manager likely to deliver in future?



Past Performance Review

Have they delivered in the past?



Value for money

Are they doing it for a fair price?

Review of investment capabilities

A forward-looking assessment of manager capabilities

What is important?



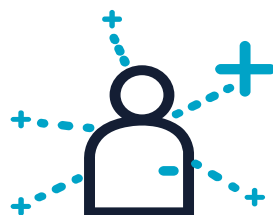
Global
Research coverage



9
Key criteria - both
investment and operational
due diligence



600
Products under
active research



Independence
Of research and
management of
conflicts

LCP view: Manager XYZ



Investment Process

The strategy aims to harvest credit beta by investing predominantly in US and European senior secured loans and high yield bonds. It may also allocate opportunistically to CLOs, special situations (including debt with equity attached) and emerging market debt.

XYZs aims to capitalise on opportunities that arise when securities are mispriced and its bottom-up credit-selection is the fundamental part of the investment process. The top-down element aids clear decision making both in terms of asset-class and geographical allocations.

The fund is managed via a sleeve approach with six specialist portfolio managers being responsible for each of the sleeves. They are tasked with populating their sleeve with their best ideas through bottom-up credit selection. Overall, we feel that the fund's process is logical and clear.

Individual portfolio managers have discretion to construct a portfolio of assets from the buy-list that match the portfolio's investment guidelines and objectives, implemented using a relative value approach.



People

We believe that the heritage of the business in this space is strong and we have confidence in the abilities of individuals we have met to outperform over a market cycle.

The individuals we have met at meetings with XYZ have come across well and demonstrably understand the intricacies and nuances of MAC investing.

XYZ is very well resourced in comparison to some other managers. We are impressed by the depth and breadth of the team and have no immediate concerns around XYZs' ability to service a growing asset base.



Firm

The legacy of this Fund lies with ABC, which merged with XYZs in 2016 along with a couple of other smaller asset managers as part of a strategic change within the parent group. The combined firm is very well resourced with an impressive client base, and has a strong track record of global fixed income and credit investing.

XYZs is a well-established fixed income manager and we believe that it is committed to the continued success of this strategy.



Responsible Investment

XYZs sees responsible investment as a natural part of the credit selection process as implicit ESG factors may impact a company's ability to service debt. It is therefore an implicit part of XYZs' process with appropriate financial rewards sought for riskier investments.

As part of XYZ's ESG assessment, environmental considerations are incorporated into a security's overall credit rating.



Our View

We have a positive view of the fund, which continues to be one of the most highly rated funds in our MAC universe. The process is reasoned and implemented by an experienced and well-resourced team who we rate highly.

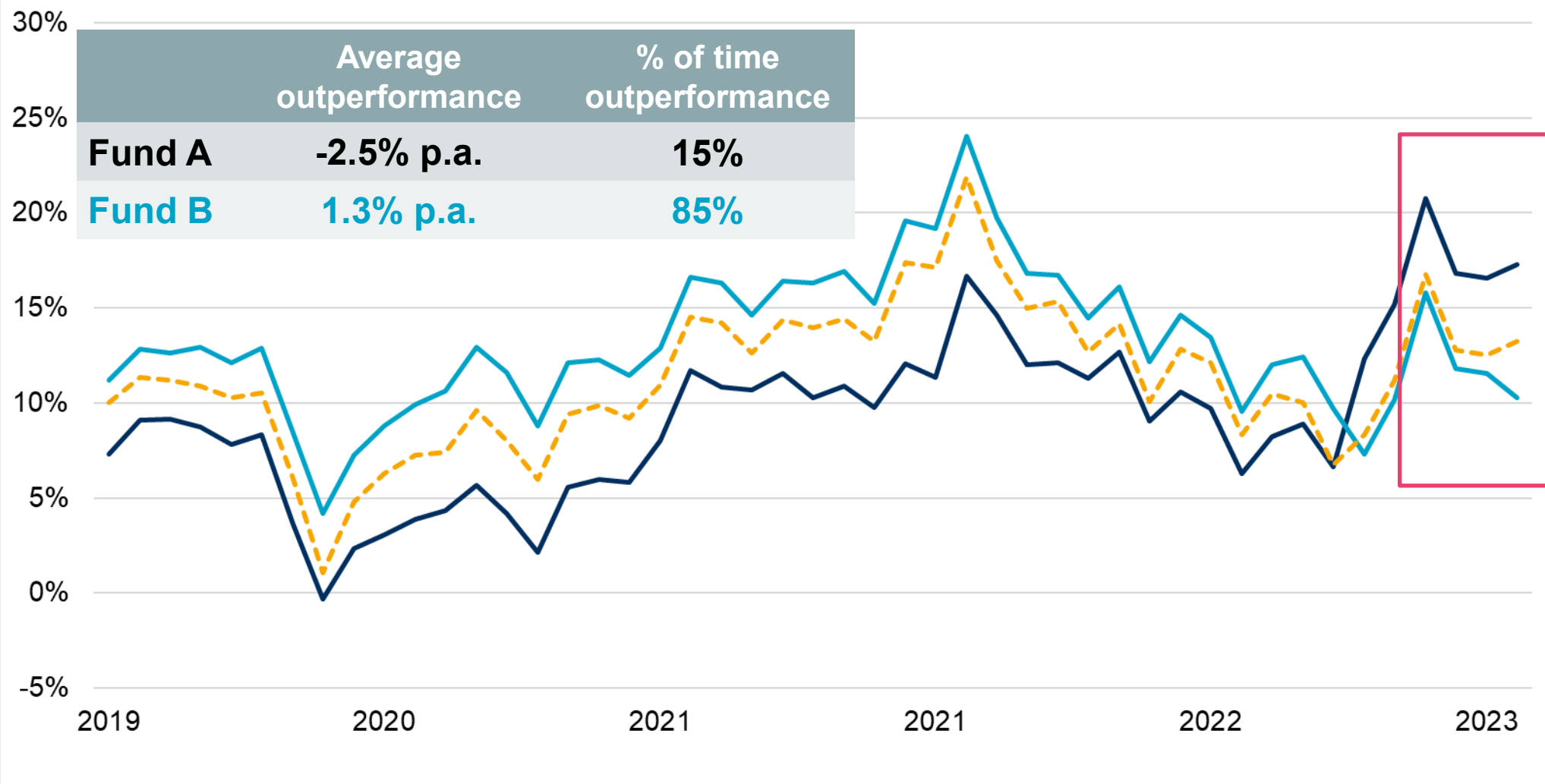
We have confidence that the team's approach, which focuses predominantly on good bottom-up credit selection with a top-down overlay, is repeatable.

Past Performance Review

Consistency is key!

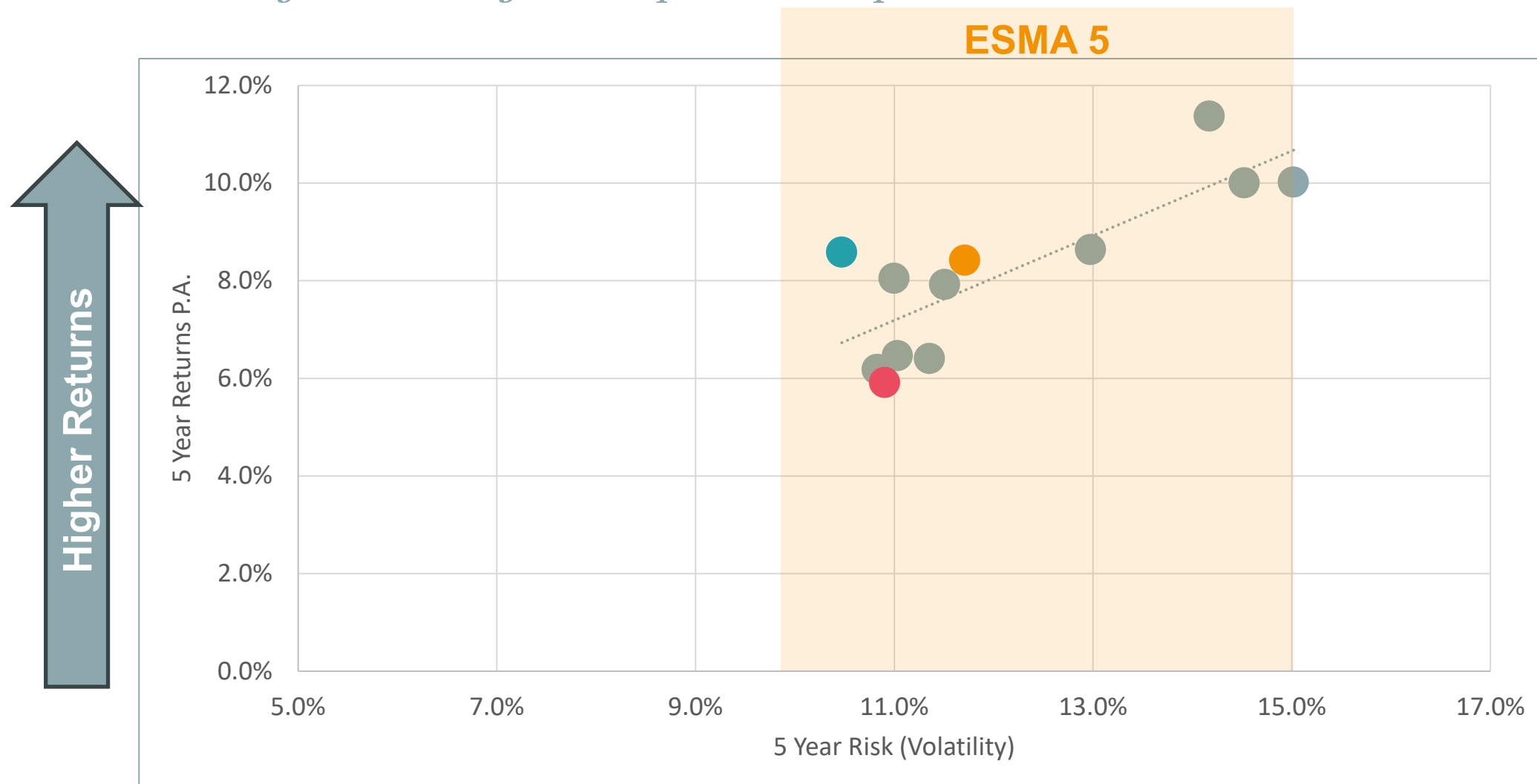
Rolling 3 year returns

— Fund A — Fund B - - - Benchmark



Past Performance Review

Understanding how managers compare versus peers

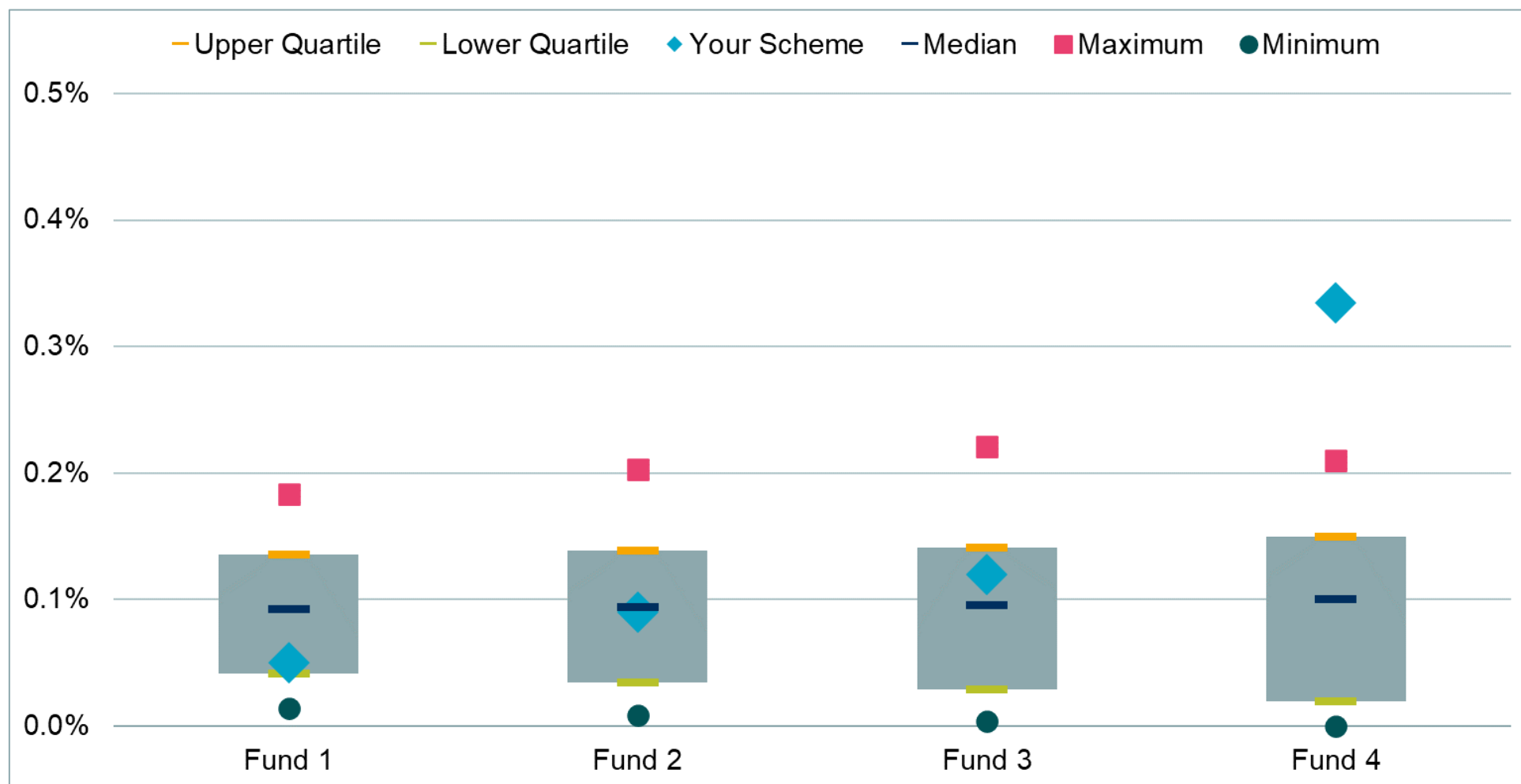
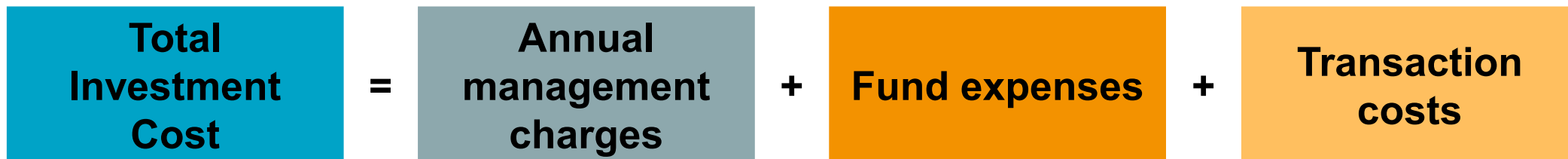


- 8.5% p.a. return, 10.5% volatility
- 8.3% p.a. return, 11.5% volatility
- 6.0% p.a. return, 11.0% volatility

Higher Risk

Value for money

Our fee survey is a useful tool for understanding how your fees stack up



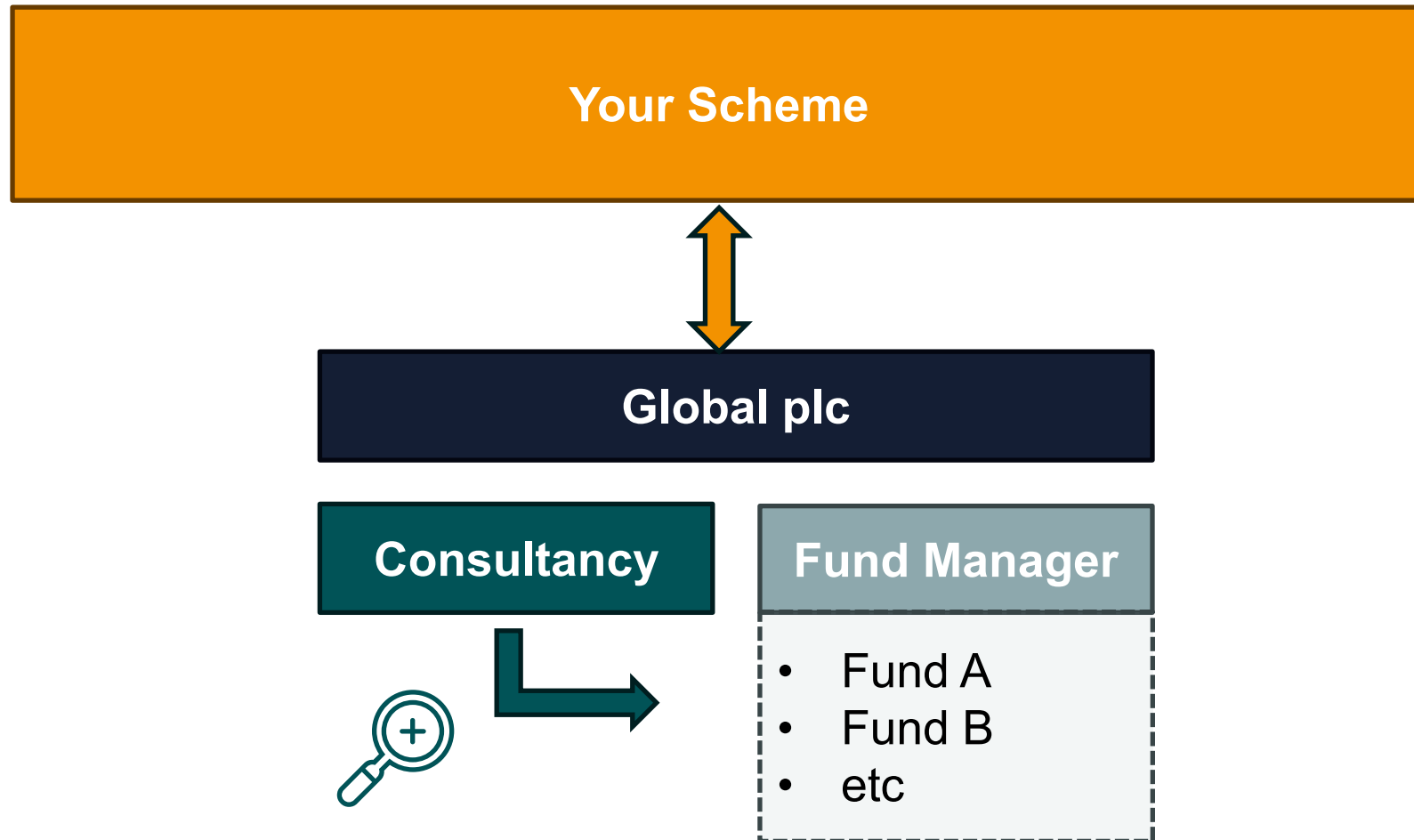
Help! I have loads of managers / funds – where do I start?

Rule of thumb – 1 critical review per manager “capability”

Manager	Fund	Appointed	Critical review needed
A	Passive Equity	2000	1
A	Passive Government Bonds	2000	
A	Passive Corporate Bonds	2000	
B	Active Multi-Asset Funds	2015	2
C	Active Multi-Asset Funds	2016	
D	Private Credit	2023	0
E	Private Equity	2018	0
F	Property	2005	1
G	Infrastructure	2014	1

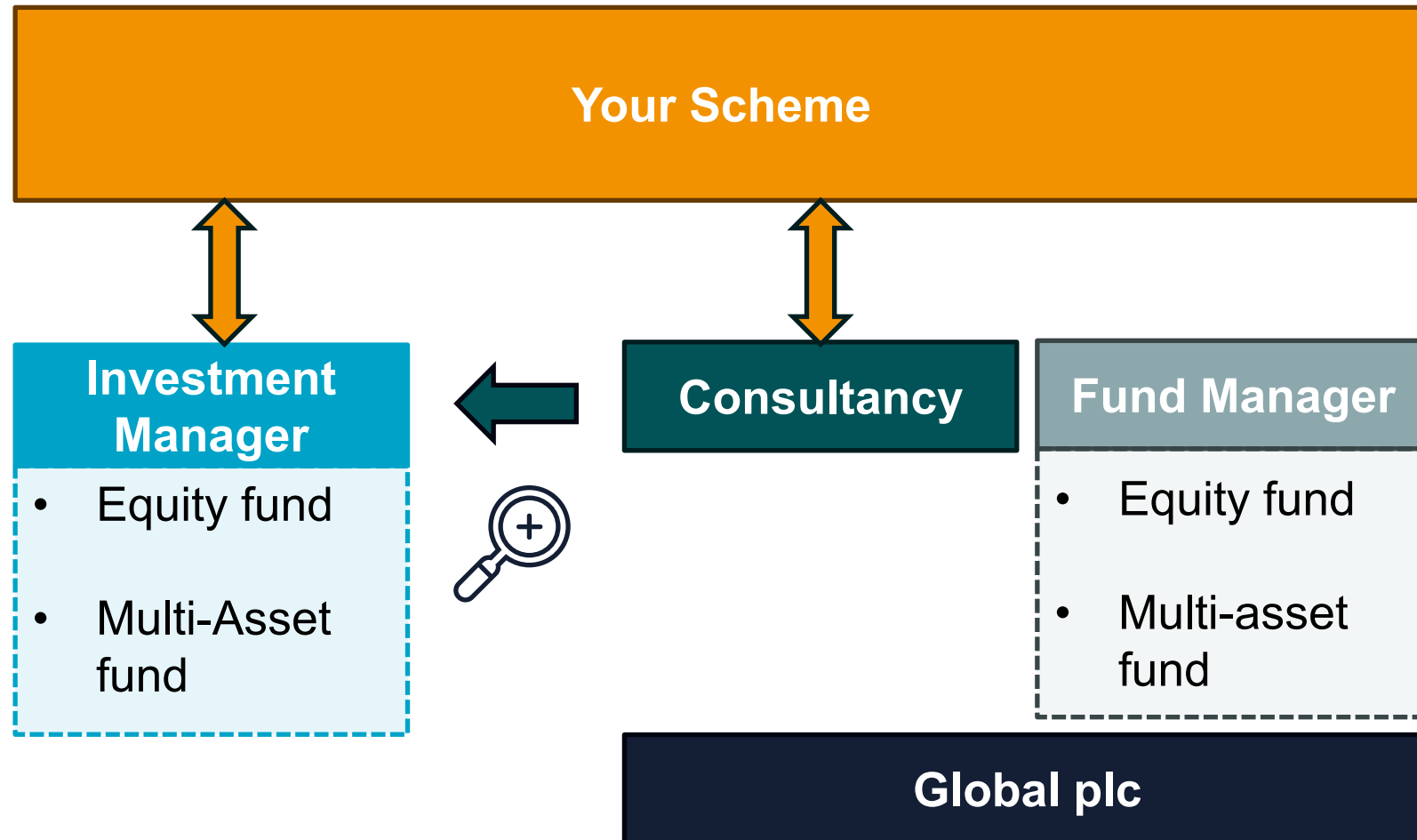
The challenges of a delegated investment set-up

Making the most of your “free” critical review information pack



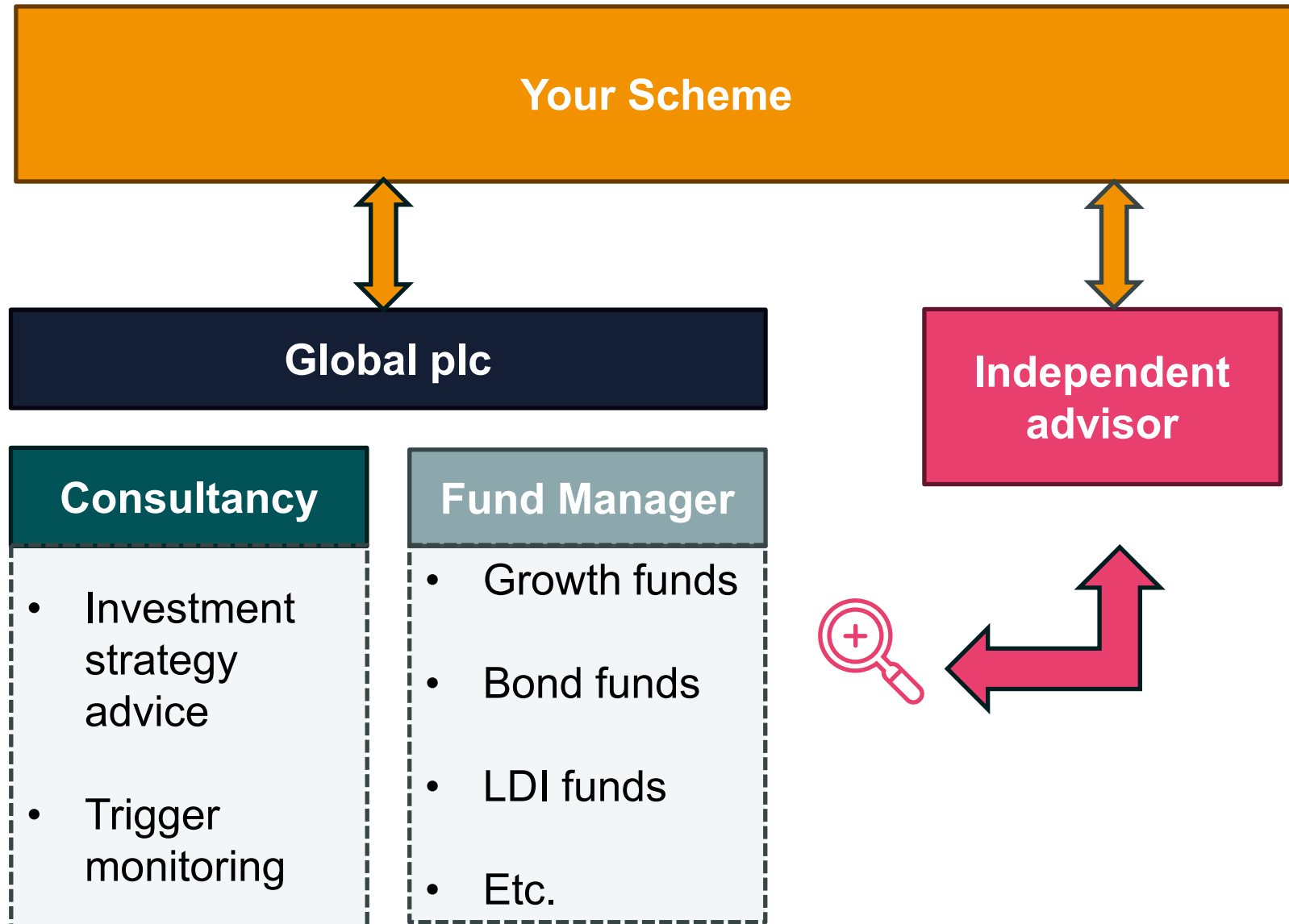
Potential conflicts of interest

Understand where there may be ulterior motives



Potential conflicts of interest

A fiduciary service is best assessed as a whole...



Key messages

What we hope you take away from today

An effective critical review is more important than the April 2024 deadline

The critical review process should add significant value for your Scheme, your Trustee board and the membership

The devil is in the detail around manager performance

Value for money should be assessed holistically

Independence and impartiality is crucial to the delivery of a critical review

Poll Question: Following this webinar are you likely to change anything about your approach to conducting critical reviews?

Today's presenters

Please contact us if you have any queries or would like to hear more

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Appendix

*Who is getting good value for money
from investment managers?*

LCP Investment Management Fees Survey
February 2022





+LCP INSIGHT
CLARITY
ADVICE

Raising the bar

LCP Responsible Investment Survey
January 2022

LCP accounting briefing 2023

