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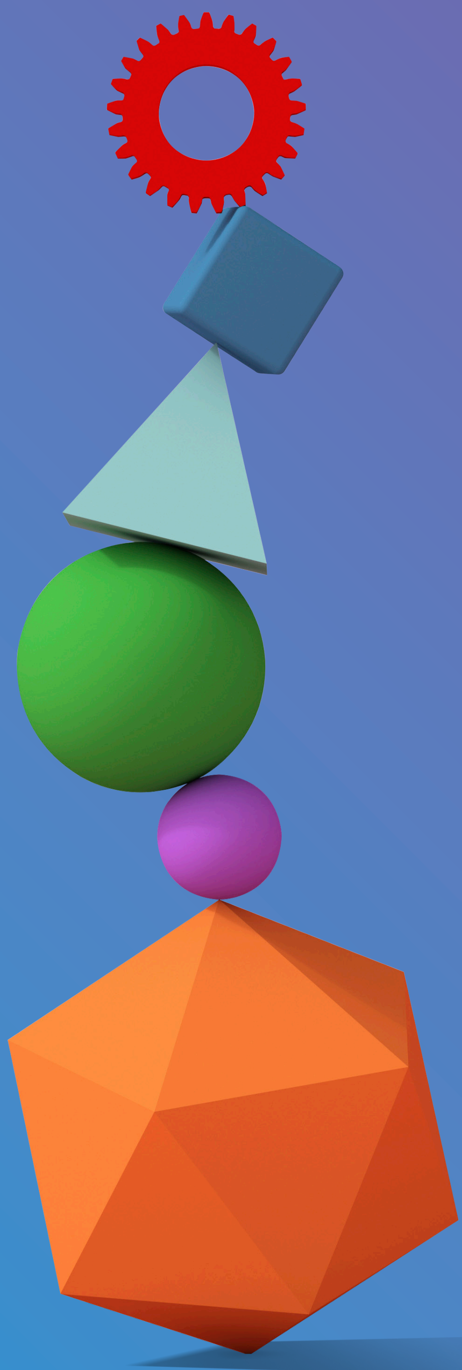
Your blueprint for resilience



Helping clients stay focused on their objectives

welcome to brighter

We're often asked why we have made building resilience such a critical focus throughout our clients' investment journey — we also call it enhancing their governance.

It's because over the past 15 years, we have seen how better investment governance can improve outcomes for our clients and enable them to keep focused on their objectives.

We know that a robust governance framework can help streamline decision-making. Assigning tasks to dedicated, experienced teams lets clients focus on what's important to them while allowing them to pursue opportunities in a cost-efficient manner. This framework should be the base from which all investors begin to forge their objective, strategy and portfolio. Without this firm foundation, things may easily — and quickly — run off course, taking time and vital resources to bring them back on track.

Better governance is all about putting you back in control.

Mick Dempsey
Global Head of Investment Solutions, Mercer

Learning from experience

The impacts of financial crises and other major market events emphasise the importance of having a well diversified investment portfolio appropriately tailored to your risk level and time horizon. The sudden and significant decline in global markets in March 2020 was no different. It provided a critical stress test for institutional investors that had on the whole seen their portfolio's generate strong returns over the previous 5-6 years. The rebound in markets since March showed again why it is important not to panic at times of high market volatility – rather it is important to assess your risk appetite, liquidity needs and return expectations and ensure you are willing and able to react appropriately to volatile market conditions.

Along with asset values falling precipitously, markets also stopped functioning as expected, which created uncertainty and considerable stress for many investors worldwide. It became difficult to buy and sell securities to rebalance portfolios and maintain allocations. And it became apparent that many investors were not equipped to seize the opportunities that arose.

While financial markets initially bounced back quite quickly, uncertainty remains, and now is no time to become complacent. There is no clarity about when the portfolios nursing significant losses will recover, or whether we will return to the volatility that we saw as the pandemic spread.

Instead, Boards, trustees and investment committees need to use this time to consider how they and their portfolios were able to react, and whether they felt confident about weathering the sudden storm. Importantly, after this period of reflection, they should be looking at the changes they may need to make — there are many lessons for the future that we can learn from the past. We believe the best way to do this is by improving overall governance. We have helped clients of all sizes and sophistication achieve it by being honest and realistic about what they need.

Challenges facing institutional investors

- Low expected returns in uncertain environment
- Operational inefficiencies and implementation timelines
- Increasing complexity and risk of regulatory requirements
- Ensuring suitability of investment strategy and investment managers
- Liquidity management
- Manager fees, transparency and other costs

Challenges facing institutional investors

Some questions our clients are asking themselves.

Was my portfolio appropriately diversified, and did it perform as I needed it to?

Did I capture opportunities that emerged, and did I do so efficiently?

Could I access the data I needed to check on my holdings and risk exposures through times of market stress?

Could I respond quickly when needed?

What do we mean by governance?

As a concept, governance means different things to different investors — and we believe this is precisely how it should be.

- Governance should provide support where you need it and not get in the way where you don't.
- It should make your task more manageable and give you confidence in achieving your goals.
- It should allow your investments to perform at the highest level, without forcing you to devote all your time and resources to it.
- It should help you understand how your portfolio might be impacted by external forces while providing a level of confidence that it is prepared to face the unexpected.

Good governance should help you:

- Set an optimal investment strategy that takes into account the financial sustainability of the employer and size of the funding gap
- Stay on top of market movements that affect portfolio allocations
- Monitor interest rate and inflation risks that can erode long-term investment returns
- Identify more obscure operational dangers, such as trade errors and liquidity traps, with the aim of reducing these risks

Having a robust governance framework helps mitigate the wide variety of risks that can dramatically impact outcomes. It can also clearly reveal where regulatory risk needs to be minimised and controlled, reducing the potential for intervention and costly errors.

Strong governance also gives investors ready access to the standardised information they need to oversee and manage the broad spectrum of costs that accompany running a sophisticated portfolio. Investment management fees and other charges, such as transaction costs and administration expenses, can also be centrally monitored through a robust governance framework.

Defining governance
Client benefits

Governance incorporates how strategic and operational decisions are made and how they are implemented, helping to ensure a more time-efficient and cost-effective approach.

Time, resources and expertise

Decision-making:

1. Strategy
2. Portfolio managers

Diversification and complexity

Making changes and responsiveness

Cost efficiency

A robust governance framework should be measureable by the investment outcome achieved.

Twelve actions for better investment governance

We believe that there are 12 essential steps that investors should take to improve their governance. These actions help build a strong base that enables investors to stay on top of what is happening today and be ready to face whatever the future holds.

1. **Objective setting**
2. **Investment strategy design**
3. **Strategy implementation**
4. **Portfolio design**
5. **Asset allocation**
6. **Manager research**
7. **Manager selection**
8. **Strategy/portfolio implementation**
9. **Rebalancing and cashflow management**
10. **Regulatory compliance**
11. **Monitoring and risk management**
12. **Governance and reporting**

Some tasks need to take place more frequently than others, and some require deep operational resources. But all are vital steps to creating a framework that allows investors to feel confident about meeting their objectives and staying in control.

Over recent years, increased regulation and portfolio complexity have soaked up the precious time of many Boards and investment committees, making it harder for them to keep up with a growing number of tasks that need to be completed regularly, accurately and in a timely manner.

It was these actions that most challenged investors as the COVID-19 crisis shook markets, leaving many of them who had not yet addressed the challenge of good governance worryingly exposed.

However, there are solutions.

Partnering for better investment governance

By splitting these tasks into strategic priorities and ongoing activities, Boards and investment committees can clearly see and decide where their time is most usefully spent — and how their fiduciary duty can be most successfully undertaken. Once decided, some may opt to build bigger internal teams to take on this list of tasks, whereas others will appoint external support to help them refocus on what is most important.

There are five broad categories of external governance, ranging from selecting a partner to conduct resource-heavy research and monitoring tasks to complete outsourcing of operations. There is no right answer to creating a robust governance framework nor should investors feel pushed into an off-the-shelf solution. Depending on size, scale, maturity, interest, along with a wide range of internal specialisations and skills, each investment strategy will need a different solution.

Some want help with strategy design, while others need asset allocation and manager selection. Investors need to feel empowered and be able to select from a menu of individual services to create the combination that best suits their needs. Above all, Boards and investment committees need to find the right partner to implement their chosen solution. Only by getting it right can they find a balance in their roles and responsibilities.

No one can predict when or how our global economy will recover, as there are too many variables, and we still do not know enough about this disease. Therefore, in this era of ambiguity, it is more important than ever for Boards and investment committees to better manage their risk to keep their objectives on track and in focus. Achieving good governance is the best place to start.

Explore what we can do for you today to prepare you for your future.

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