

HEWITT, BACON & WOODROW, 2004. *Investing pension funds as if the long term really did matter.*

UKSIF summary, 2009.

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I. Key points

- This report brings together ideas from 88 entries which participated in the global competition launched by Hewitt Bacon & Woodrow and USS in 2003 named “As if the long term really did matter”. The hypothesis was a mandate for a global consortium of pension funds.
- Some suggestions:
 - Investing for the long term:
 - Split the asset allocation between protective asset class and active class, the former comprised of low-risk fixed income investment for meeting liabilities.
 - Set a turnover limit to restrict sales and purchases in the portfolio
 - Monitor the holding period of investments and question the fund manager if any were held for less than 5 years
 - Bias portfolio towards companies linked to pensioner’s consumption patterns
 - Integration with liabilities: making a closer link to liabilities helps pensions funds control the true risks of their investment strategy
 - Organizational structure and incentives: change is likely to meet with considerable resistance as the current structure sees fund managers well rewarded, regardless of whether they succeed or fail
 - Split fund manager’s fee between fixed management fee and performance fee, the latter based on a rolling 5-year performance.
 - Split manager’s fees into basic costs’ fees, on a quarterly basis, and long-term outperformance fee.
 - Reward fund managers with shares in the fund they were managing
 - Defer bonuses to managers in three years to evaluate the impact of their investment decisions in the long-term
 - Contract fund managers as contracts of employment, presuming continuity

- Measuring success: the lack of new or radical ideas on the measurement of success indicated the difficulty of breaking away from current practices
 - Changing the focus from improving returns to managing risks
- Rewarding corporate responsible behaviour:
 - Establish a committee to identify the issues of concern for most scheme members
- Responsible asset allocation: it is not part of traditional fund management practice to actively consider asset allocation to improve the quality of life in retirement for current pension fund members
- Influence:
 - The consortium should support an institution to train and support high-quality independent board candidates and this institution would then invest in companies appointing these directors
- Impact: area least well-addressed by the entrants to the competition
 - Investigate the ESG impacts of a company before buying its stocks
 - Offer students a loan service to increase the number of students to go to university and have positive impact on society

II. Key quotes

- “We were looking for a believable and clear definition of a long-term (10- to 20-year) mandate.” (Hewitt, Bacon & Woodrow 2004, p. 2)
- “...responsible investing in property could include action to enhance the environmental qualities and community use of the property owned to improve its value” (Hewitt, Bacon & Woodrow 2004, p. 4)
- “Traditional ad valorem and performance-related fees based on out-performance of conventional index benchmarks, paid annually, provide little incentive for long-term performance” (Hewitt, Bacon & Woodrow 2004, p. 8).
- “The judges recognized that most current investment practice does not encourage fund managers to play an active role in influencing the actions of the companies in which they invest” (Hewitt, Bacon & Woodrow 2004, p. 13).