

▶ ILO SSO Project

Investment Governance Workshop

Day 1: Principles and structures

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▶ Investment Governance

What is Investment Governance ?

« Decision making and monitoring process »

Why is it important ?

Good Governance -> good practice

Improves transparency, accountability and reporting

Adds value in low return times

Five critical factors in success of a Good Governance Process:

1. Clear Mission
2. Managing agents
3. Risk Management
4. Time horizon
5. Innovation Capability

Governance is:

1. Doing things right
2. Doing the right things

▶ Investment Governance: some questions

Why do you need a Funding Policy ?

How do you set an appropriate risk budget ?

Who makes what decisions on investment ?

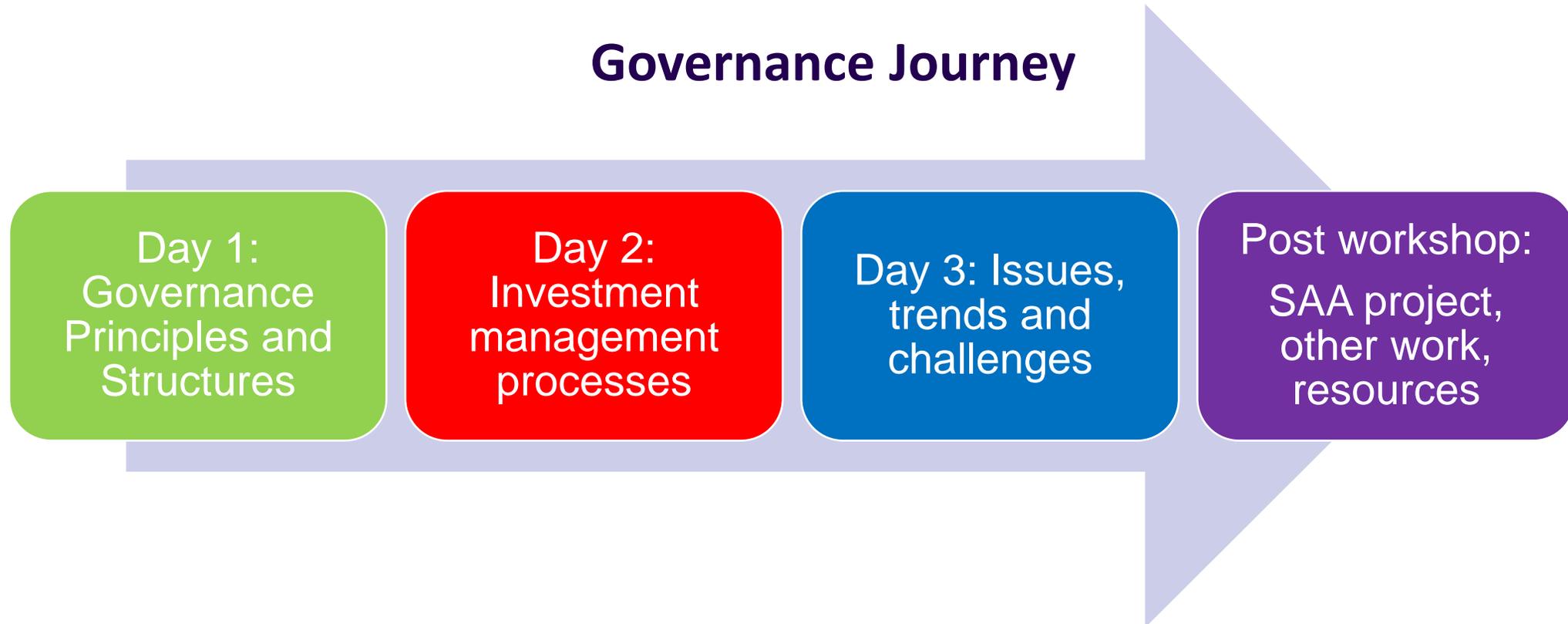
What factors influence the approach to diversification ?

How do Investment Beliefs drive investment choices ?

What drives choice of external managers ?

Structure of SSO Investment Governance Workshops

Governance Journey



Investment Governance workshop

Aims

- Exchanging information, views and experiences
- Discussing challenges
- Transfer of knowledge / case studies
- Identifying the key barriers to change
- Developing action / work plans / foundation for follow on work

It is not..

- Going to provide 'an answer' but simply
 - ▶ *The issues to consider for improving governance*
 - ▶ *Some ideas about approaches to follow*
 - ▶ *Practical measures to take & a framework / work plan*
 - ▶ *Examples of international practice*

▶ Investment work under the ILO SSO project

- Investment Governance Workshops Day 2 and Day 3
- Strategic Asset Allocation related
 1. *Link of liabilities to investment management*
 2. *Funding Policy and Investment Policy Statements (IPS) for the sub-funds in SSF and WCF*
 3. *Liability driven asset management models for SSF and WCF*
 4. *Implementation Plans for SSF and WCF*

Information day and workshop for the Board
Training on liability profiles / actuarial valuations

Using the ISSA Investment Guidelines

► **Appropriate investment governance structures and mechanisms ensure effective management of social security reserve funds**

Guidelines provide the framework (the what) in:

Setting objectives and clarifying responsibilities

Defining, carrying out and monitoring an appropriate investment strategy;

Assessing risks and investment performance;

Reporting results and disclosing information.

Investment Governance important because:

Social security must meet its benefit obligations.

Risks are more complex and the external environment more challenging than ever before.

Effective management improves the financial position of social security systems.

We will use the Guidelines as a checklist of what to consider

We will use case studies, resources and international experience on how to apply the requirements

Resources for Investment Governance work

Workshop Slides

Articles, documents and resources

Case studies

ISSA Investment Governance Guidelines with supporting references

ILO expertise and experts' experience

Investment Workspace



ISSA Guidelines

Investment of Social Security Funds

Revised edition 2019



ILO SSO Project: Investment



SSO ILO PROJECT: INVESTMENT WORK AND TRAINING



Private

CONTENT

List

Main page

Investment Governance Workshops

Other resources related to the investment work

SECTION

Resources

News

This workspace contains resources related to investment and financing work under the ILO SSO project: “Strengthening Social Security Office Capabilities in Policy Design with a Focus on Research and Actuarial Services”.

The project plan provides for the following work under the overall objective 2.6 , (The development of a Funding Policy and reviewing the Investment Policy):

- Activity 2.6.1 - Workshop with SSO Board and Management on financial governance of social security and the importance of a coordinated management of benefits, funding and investment policies
- Activity 2.6.2 - Create link from actuarial valuation projections to investment management
- Activity 2.6.3 - Training on ISSA Investment Governance Guidelines
- Activity 2.6.4 - Assessment of current regulations, assessment of international practice and recommendations
- Activity 2.6.5 - Drafting of a funding policy
- Activity 2.6.6 - Collection of data on assets classes available to invest SSO funds
- Activity 2.6.8 - Recommend an Optimal Asset Allocation based on either an efficient frontier or a stochastic model, and implementation plan depending on availability of data

Workspace: one SSO investment log in will be circulated

<https://www.social-protection.org/gimi/ShowProject.action?id=3113>

▶ Breakout Session 1

Participants were asked to use the post it notes provided to summarise where they felt the investment function was and where it should be going

GREEN /BLUE : Things that work well / positives that you want to share

PINK: Challenges , problems, constraints

YELLOW: Resources / solutions / good ideas

ORANGE: Questions / what you would like to know more about

The responses have been summarised separately and will be referred to in forthcoming data work

1. Investment Beliefs

Strong investment beliefs that command institution-wide support, are aligned with objectives and inform all investment decision-making, are agreed and documented.

These are often implicit, undocumented or unstructured in organisations – we need to make them **explicit, documented, detailed** and **with priorities**

Beliefs are working assumptions about the investment world that underlie investment practices

When developed and shared, they help make goal setting and decision-making more effective.

They reflect views on the investment goal as well as beliefs on alpha and beta which will drive the investment approach and strategy.

Examples include:

“we believe that a diversified approach is best”,

“we believe that we should manage our investments internally where possible”.

“we avoid investments in certain countries”

“ESG is an investment belief”

Investment Governance Principles

1. Investment Beliefs

High-level beliefs should be set out by the board, management / investment committee about:

- *Asset class pricing including the “fair” prices of investment opportunities and the reasons why mis-pricing can occur*
- *The investing institution’s ability to exploit its comparative advantage;*
- *How the investing institution might develop and integrate these beliefs into its investment strategy;*
- *What these (alpha and beta) strategies can produce in terms of value added and risk, both individually and together across the whole portfolio*

Beliefs should be consistent with SSO’s goals and objectives

2. Investment Mission and Goals

The investment mission and supporting goals are clearly defined and have commitment from the relevant stakeholders.

Mission requires supporting goals

Mission should respect legislation

Abstract objectives supported by second order operational goals

Examples:

- ▶ Objective: Maximising beneficiary welfare
- ▶ Operational goal: Target rate of return allowing for liabilities and subject to agreed risk parameters

2. Investment Mission and Goals

Recommendations:

The board should adopt a clearly defined and well-specified investment mission agreed by all stakeholders

Different components require assigned priorities

The Mission should be supported by specific goals and be consistent with legislation

The goals should specify financial success over a certain time period

▶ Missions, Goals and Beliefs

France Retirement Reserve Fund:

The FRR's mission as conferred by law is to “manage the sums that are allocated to it, to build up reserves to help ensure the long-term future of eligible retirement plans”.

Canada CPPIB Mission

- We invest in the best interests of CPP contributors and beneficiaries.
- We have a singular objective: to maximize long-term investment returns without undue risk, taking into account the factors that may affect the funding of the Canada Pension Plan and its ability to meet its financial obligations.
- We provide cash management services to the Canada Pension Plan so that they can pay benefits.

▶ Missions and Objectives: ATP Denmark

Investment Policy based on four criteria:

- 1. Avoid risks for which we cannot obtain compensation:** Our pension liabilities are hedged to cover changes in interest rates. This is managed in an independent hedging portfolio.
- 2. Efficient risk diversification:** The return on the investment portfolio should be as stable and as independent of economic trends as possible. Therefore, we diversify risks as efficiently as possible by breaking our investments down into five risk classes.
- 3. Insurance against very negative events:** We supplement our risk diversification with insurance strategies to reduce the likelihood of disastrous losses.
- 4. Appropriate risk level:** We adjust our investment risk relative to the size of ATP's reserves.

► What about this as appropriate guiding principles / goals for the SSO ?

- 1) Seek a nationally, regionally and globally diversified investment portfolio: 50% Thailand, 25% Emerging Markets, 25% Developed Markets
- 2) Reflect liability structure and characteristics including duration, projected benefits, inflation sensitivity and discount rate
- 3) Support Thailand economic development plan and Thailand climate change master plan

3. Bodies and their Responsibilities

Investment functions will be undertaken by different bodies or institutions. In order for the governance process to be effective, the roles and responsibilities of each body and how these interact will be clearly defined and communicated.

The **Board/governing body** is responsible for governing the SSI and overseeing administration.

Board may appoint an investment committee to develop investment policy and strategy, and oversee implementation.

Management is responsible for administration and daily operation.

Management may establish investment units to carry out investment activities.

Questions

Why is it so important that the responsibilities of various bodies (board, investment committee, management, investment units, etc.) are clear, free of conflicts, well documented and understood?

What qualities/ skills should the board and management have?

Which external authorities should oversee the performance of the board and management?

▶ CPPIB Canada – Guidelines and ToRs for the Board

Terms of Reference define the role for the Board, its duties and responsibilities. It covers

- Delegation powers and restrictions
- Responsibilities – e.g establish Investment Statements and Risk Policy and review at least annually
- Culture – covering ethics, conflicts of interest, Code of Conduct etc
- Management oversight – eg on human resource issues
- Strategy, Plans and Policies – eg require management to have a risk management plan
- Auditing, compliance and communication
- Legal obligations of the Board
- Board Timetable

Guidelines elaborates on the ToRs with reference to duties and responsibilities, Board membership and committees, Board meetings and issues for directors. For example: different committees required and their scope, number of members, frequency of meetings, reporting etc

▶ 4: Fiduciary responsibilities

The board and management have a fiduciary duty in administering and managing the funds of the social security institution.

Responsibilities of the board and management should be defined in the legislation, policy or decree.

Investing institution should follow the prudent person principle in managing investment fund.

Periodic reviews of performances at all levels must be carried out.

Decision making processes at all levels must be clear, transparent and well documented.

▶ Questions

What is the “prudent person principle”?

Who carries out periodic reviews of performance?

▶ 5: Structure and organization of social security institutions

The investment structure and organisation of the investing institution is consistent with legislation, guidelines and industry best practice for investments.

The **Investing institution** may be the social security institution itself or another entity established for investing fund assets.

Operational independence of the **investing institution** must be demonstrated.

Responsibilities definitions and structures should cover board and its committees (audit, governance, human resources, risk, etc.).

Reward and compensation structure must be established to build a reserve of talented professionals.

Investment Governance Structure example

Board / Governing Body

- Responsibility to govern institution
- Oversight on administration
- May be Ministry / Department
- Should ensure that investment related risks identified & managed

Management

- Responsibility for administration and daily operations of social security institution & Investing Institution
- Should identify investment related risks, propose policies to manage & reduce these

Investing Institution

- Either the entity administering the Social Security Institution or an entity established expressly for the purpose of investing the scheme's funds

Investment Committee

- Appointed by Board or Investing Institution. Responsible for
 1. Developing the investment policy and the investment strategy
 2. Recommending them to the governing body
 3. Overseeing their implementation, and
 4. Assess if effective

▶ Case Studies

The case studies are based on two fictional social security provision frameworks

Strackland,

Defined Benefit system, retirement based on salary, normal retirement age 62

Financed by employee (8%) and employer (10%) contributions

Dinaterra

Provident Fund system financed by employee (5%) and employer (7%) contributions

Minimum return of 7% per annum, normal retirement age 60

Asset class	%
Equities – domestic	15
Equities – global	30
Domestic bonds	30
Global investment grade credit	12
Property – domestic	5
Hedge funds	5
Cash	3
<i>Total</i>	<i>100</i>

▶ Case Studies

Case Study 1: Governance Principles

Case Study 2: Governance Structures

Case Study 3: The Risk Budget and Dynamic Investing

Case Study 4: Portfolio Construction

Case Study 5: Active versus passive management & benchmarks

Case Study 6: Internal Investment Management

Case Study 7: External Investment Management

▶ Case Studies

We will look at two case studies today in four groups:

Case Study 1: Governance Principles

Group 1 MISSION AND OBJECTIVES

Group 2: INVESTMENT BELIEFS

Case Study 2: Governance Structures

Group 3: GOVERNANCE STRUCTURES & RESPONSIBILITIES OF EACH BODY

Group 4: FUNCTIONALITY OF EACH BODY

▶ Case Studies

Split into groups of 4 or 5 so that we have 4 to 6 groups

I will hand out the background of the case studies and you will discuss in groups

Choose a spokesperson who will present the findings

Ideally choose to work with colleagues you don't normally work with

You have 20 minutes to draw up your responses

Summarise your group's findings on the flip chart

Be ready to present

▶ Case Study 1: Group 1

BACKGROUND

1. Looking over the 25-year history of the fund, are the periods between significant mission changes appropriate?
2. Consider the above trigger points for review and change – are they appropriate?

MISSION AND OBJECTIVES

3. Discuss the appropriateness of each mission statement above.
4. Discuss the appropriateness of each objective above.
5. Consider alternative mission statements that could be applicable both at fund inception, seven years ago and after the current review. Consider accompanying objectives at all three stages.
6. In order to implement a mission statement and objectives, what are the processes that should take place?

▶ Case Study 1: Group 2

INVESTMENT BELIEFS

7. Considering the investment beliefs as a whole, identify the areas of consistency and any of potential conflict or disagreement. What are the key elements in belief statements that have to line up for them to be most effective?
8. Are there any areas that are missing from the beliefs? Are there any elements which are unnecessary? What would you add or take away?
9. To what extent should investment beliefs build in flexibility, or the ability to apply across multiple scenarios?
10. Do you agree with the beliefs? What would you change if re-writing the statement yourself?
11. What represents a good process around creating beliefs and transferring them into the investment strategy?
12. What is needed for beliefs to be a success? What role do they play in an organisation?

Case Study 1: Key points

INVESTMENT MISSION and OBJECTIVES

Mission should be closely linked with the identity and culture of the organisation

Basis and input into the investment objectives but the two should be distinct – this isn't the case here where the mission and objectives are blended

Should be stable and changed only infrequently – success judged over 10+ years

Objectives should be SMART; mission should be clear

Should be reviewed regularly & appropriate triggers (to review) defined in advance

Case Study 1: Key points

INVESTMENT BELIEFS

Underlie almost everything the investment function does

Objectives should be checked back against beliefs especially when there is a change (eg external management)

Right balance between narrow and broad

Are they all beliefs ?

Case study example

Some inconsistencies (eg belief 9 and 11)

Beliefs should be stronger around controversial areas (eg active management)

Also could add more beliefs around governance and external managers

▶ Case study 2 : Group 3

GOVERNANCE STRUCTURES

1. Discuss the original Board-ISC set-up of the fund. What are its strengths and weaknesses?
2. Discuss the evolved governance set-up with the Board, IC, and internal team. Is this an improvement?
3. What elements are missing from the current set-up that you would include?

RESPONSIBILITIES OF EACH BODY

4. Are the reporting lines of each body appropriate and effective?
5. Discuss the use of external experts and their roles within the governance structures.
6. Construct an idealised responsibilities matrix, using the structures in place at the fund currently, as well as any additions from question 3.

▶ Case Study 2: Group 4

FUNCTIONALITY OF EACH BODY

7. What is the best level of influence that each body has in directing the investment activities of the fund?
8. How should each body interact with each other, and what are the best outcomes of this?
9. What skills should be present at each level of the organisation?
10. How do you ensure that these skills are present when selecting members of each body?
11. What role should training play in the organisation?

▶ Case Study 2: Key points

GOVERNANCE STRUCTURES

No definitive right and wrong answers to governance structures but should reflect fund's context.

But important to have at least 4-6 members and half independents

Governance budget, expertise and speed of decision making other factors

Possible additions to structure proposed include:

- ▶ Supervisory Board (a body above the Board that monitors its effectiveness and impact)
- ▶ Audit Committee
- ▶ ALCO (asset and liability committee)
- ▶ Risk Committee

▶ Case study 2: Key points

RESPONSIBILITIES OF EACH BODY

For each body, define in the ToRs who is their primary responsibility and duty due to and what are the reporting lines and frequency

External expertise should fill knowledge gaps & provide impartiality

FUNCTIONALITY OF EACH BODY

Balance between board and executive

Too much in the former -> too rigid

Too much in the latter -> lack of control and oversight

Skills need to be recruited (key role for nominations committee)

Or trained up (Strategic at board level; operational at executive level)

▶ Example of responsibilities: 'Q Super'

Framework setting out which bodies responsible for which actions. For example:

Investment Beliefs

Beta management

Alpha Management

Manager selection guidelines etc

Body proposes, recommends, approves as appropriate

For example:

Asset allocation proposed by investing institution, recommended by investment committee & approved by Board

Potential Ownership Matrix

	Input	Owner	Approve	Oversee	Review frequency
Liabilities (where relevant)	External	ALCO (<i>Asset Liability Committee</i>)	IC	Board	Annual
Mission, goals and beliefs		IC	Board	Supervisory Board	Annual
Strategy		IC	Board	Supervisory Board	Quarterly
Portfolio construction	CIO	IC	Board	Supervisory Board	Monthly
Monitoring	CIO	Risk committee	IC	Board	Monthly

Summary of the Day

We have:

Set out the framework and aims for the 3 day workshop

Covered the building blocks of investment governance

Worked on Case Studies on beliefs, aims, principles and structures

Sketched out how to address the issues / problems raised in the SoPs

What we have ahead:

Day 2: Investment management processes (Date to be confirmed)

Day 3: Investment manager issues, trends and challenges (Date to be confirmed)

Key action points ahead

Structures and responsibilities

Beliefs, Missions and Goals

Investment Policy and Funding Policy

Risk Budget

Liability driven investment



These steps to be addressed over the next few months

Thank you

Simon Brimblecombe