Trustee Leadership Forum for Retirement Security

Second Annual Convening

May 30-31, 2012

On May 30th and 31st, the Trustee Leadership Forum for Retirement Security, a project of the Initiative for Responsible Investment at the Hauser Center for Nonprofit Organizations at the Harvard Kennedy School, convened a mix of forty-four pension fund trustees, labor union affiliates, fund managers, financial consultants, and legal professionals to discuss issues currently affecting pension fund investment plans. The convening spanned two days, the second day reserved solely for trustee participation.

The goal was to facilitate and engage in conversations regarding the specific challenges trustees face when making investment decisions given the current political and economic context. The hope was to build a common foundation and support system in which these issues can be addressed in a productive fashion by identifying characteristics and tools for trustee leadership. The core framing topics for the days discussions were fiduciary duty, agency issues, financialization and the real economy, as well as the conflicts and contradictions trustees face as they work to meet 'the target return number' for their funds.

How can we determine that what we are investing in is creating a more robust economy?

An integral theme of this convening and the Trustee Leadership Forum project as a whole is how trustees can be best educated in their investment decisions. The conversation around fund returns was thus framed to address how trustees can get the information they need to understand not only where their returns are coming from, but how to best incorporate their investment beliefs into conversations around investment decisions. The question then becomes how trustees can get accurate and transparent information to make these informed decisions that contribute to a robust economy and long-term, sustainable returns for their fund. The target return rate cannot be ignored but by incorporating investment beliefs into investment conversations, there can be greater alignment between financial returns and social interests.

Trustees get their information regarding potential investments through fund managers and consultants. This information, at times, can be overly complex, ill explained, one-sided, or delivered in such a volume that it is not feasible for trustees to actually utilize when making investment decisions. Participants discussed that to combat this asymmetry of information, trustees need to play a larger role in shaping the investment agenda of their fund and facilitate greater transparency. One potential method suggested was to have trustees screen the questions asked to fund managers by the staff during the selection of managers' process.

Multiple trustees noted that there is an asymmetry of information and investment opportunities presented to funds based upon the size of their fund. Smaller funds felt that they were taken advantage of at times in that they were not provided the same transparency and coherent explanation of investment opportunities. The question thus becomes how all trustees can empower each other and level the playing field for all, regardless of fund size. Attendees spent time at the end of the May 30th

session coming up with a list of concise questions that trustees from all kinds of funds can use to help facilitate a manageable and useful flow of information on issues of highest importance.

Top Questions for Fund Managers:

1. Tell me in layman's terms, step by step, how you do what you do. Where do your investments returns come from?
2. What sorts of risks do you identify? How do you measure and manage them? What systems do you have in place to look for different kinds of risk-unlikely events, unexepected correlations, and so on? What happens when things go wrong?
3. You have all of the information about the investment products. How do we know that we are getting full disclosure about any unnamed risks and obstacles? What internal transparency measures do you have in place?
4. How does this investment match our investment beliefs and strategies? How does it complement our portfolio?
5. What measures, other than relative performance, should we use to evaluate your past performance? Your performance going forward? What benchmarks are you using and what are the drawbacks of those benchmarks?
6. How do your investments affect society? Do they cause collateral damage, externalize costs? Do they create benefits? How does your investment strategy take the social and environmental impacts of your investments into account?
7. How do you make your money? How is the firm compensated, and how are the people who work there compensated? How are your interests aligned with ours when things go well and when they don't? Have you agreed to lower fees with other clients than what you are asking us to pay?
8. Have you been subject to regulatory settlements or litigations? Does your firm belong to trade associations? If so, how much does the firm pay annually and how are these payments justified?
9. How has the crisis changed how you think about investments? What actions have you taken to contribute to financial market stability? How have you handled debates over financial market regulation? How much money do you spend on lobbying?

Where does leadership reside in redirecting funds?

Many of trustees' identified concerns stem from a 'cult of expertise' amongst fund managers and staff that leads trustees to abdicate too much of their leadership to outside actors that may not be as well-versed in issues important to funds as trustees assume. In an economic landscape that is drastically different since the 2008 financial crisis, there is a need to find managers and staff who are educated in these changes. These questions were tackled at day two of the convening.

May 31st was reserved solely for trustee participation as an opportunity to expand on specific areas such as risk management and private equity. Risk was of particular interest to attendees, due in large part to the effects of the financial crisis that forced considerations of nontraditional risk to play a larger role in investment decisions. Discussion was framed primarily around how trustees can confront nontraditional risk, once again emphasizing the importance of understanding what is within your fund's portfolio and what types of risk your fund is taking on when making an investment.

The issue of ethical risk was an interesting topic of discussion that brought up the bigger issue of what exactly the fiduciary duty of trustees is as well as the importance of incorporating investment beliefs into fund discussions of financial investments. Risk management strategies that were suggested

included: incorporating investment beliefs into investment discussions and fund guidelines, engaging directly with beneficiaries and other stakeholders on issues that are important to them, playing a greater role in electing consultants and fund managers, and creating a 'B Team' during investment discussions whose purpose is to challenge the merit of a potential investment.

Creating versus reacting to the market

Private equity served as a constructive framing vehicle to discuss the relationship between investments fund make and the broader impacts of those investments on beneficiaries. What sorts of questions do trustees need to be prepared with when sorting through private equity investments? One glaring issue this discussion brought about was that since 2008, there has not been a great change in how funds are managed and how investment decisions are made. Attendees noted that if the current structure was working and private equity investments were performing as expected, the multitude of plans that are underfunded would not exist. The continued failure to ignore downside risk and the hesitance to change current investment structures exacerbates the effects of the financial crisis on funds. Despite existing concerns over fund and investment management, trustees felt that there is potential to make important changes within their fund. They feel that they do not need to 'reinvent the wheel' and that there are solutions out there that can be applicable to their unique fund needs.

A common refrain from trustees was the importance of cross fund collaboration. Convenings like the Trustee Leadership Forum help to forward these conversations and allow for greater regional engagement and collaboration. Collective action and encouragement of an inquisitive environment within funds coupled with decisive research are important steps towards trustees playing greater leadership roles within their funds.

Timing is right for these conversations to take place and for real changes to be made. Numerous trustees and participants alike noted that movements like Occupy Wall Street and the general malaise with our current financial markets provide a rare opportunity for pension funds lead by empowered trustees to demand changes in investment patterns that will truly provide for their beneficiaries.