



Building strong foundations: Effective use of time

How to ensure that decisions are made by the right
people at the right time

Going from good to great

We have long argued that **good governance** is a key factor that distinguishes the very successful asset owner funds of the world.

In 2007, Roger Urwin (Willis Towers Watson’s Global Head of Investment Content) and Professor Gordon Clark (Oxford University) conducted a landmark study of investment governance*. The study was carried out by examining ten exemplar funds, which were selected on the basis of their reputations for strong decision-making accompanied by performance success. The key conclusion of the study was that **strong governance is a critical requirement to allow organisations to achieve above average investment outcomes on a sustainable basis**.

The study identified twelve traits that are shared by the most successfully governed institutions. These are briefly summarised below:

‘Core’ business traits	‘Exceptional’ business traits
Mission clarity	Highly competent investment executive
Effective focusing of time	High level Board competencies
Leadership	Supportive compensation
Strong investment beliefs	Competitive positioning
Risk budget framework	Real-time decision making
Fit-for-purpose manager line-up	Learning organisation

* Best-practice investment management: lessons for asset owners from the Oxford-Towers Watson project on governance, Gordon L Clark and Roger Urwin, September 2007.

This note is part of our **Building Strong Foundations** series which addresses these 12 factors in turn. In this note we focus on the related factors of Effective focusing of time and Real-time decision-making. We explore how specification of roles and responsibilities, appropriately delegated authorities and well thought through and adaptable decision rules enable swift decision-making even in the case of uncomfortable decisions. Further, we set out some delegations¹ and a case study of how we work with clients to develop their decision rights.

¹ We note that any delegations exercised must be in accordance with the legal structure of a fund and all relevant laws, case laws and regulations that apply. Hence obtaining appropriate legal advice around the extent of delegations permitted is vital prior to the Board putting any new delegations in place.



A primer on the role of the Board

When we look at best practice asset owner organisations, a key differentiator between poor to average and good to very good practices can be found in the roles and responsibilities that the Board assumes and the clarity with which it delegates decision-making authority down to its committees and to the executive team.

Effective Boards spend time in highly disciplined ways and apply their attention only to the most important issues. In better performing organisations, the Board is clear that it has four primary functions. An effective Board understands that its function is to:

- establish the organisation's vision, mission, values, investment beliefs and policies
- set high level investment and, where appropriate, organisational strategy
- appoint the Chief Executive and delegate strategy execution to management, or an outsourced provider
- exercise accountability to relevant stakeholders

Having delegated strategy execution, effective Boards understand that they need detail on strategy implementation only to fulfil strong oversight of management. They focus instead on the consistency with which management (or the outsourced provider) is adhering to decision-making frameworks which the Board has taken time to understand.

In contrast, less effective Boards spend far too much time in the detail of execution. They want – or believe they need - to be involved in every decision.

To deal efficiently with their whole agenda, Boards will often create a sub-committee structure. Depending on the complexity of the organisation, these committees might include:

- Investment
- Audit and Risk
- Remuneration / Human Resources





Establishing the role of the Investment Committee

There are a variety of reasons why a Board might decide to establish an Investment Committee, including when:

- investment management is not the primary purpose of the organisation – a corporate pension scheme is a common example here
- the Board lacks technical competence in investment management issues and wants to co-opt in such experience – for example, this can apply to some representative employer/employee Boards
- the complexity of the organisation means that the Board has multiple other elements to focus on – large asset owner organisations working in a competition-for-members environment would be likely examples here

Whether or not an organisation adopts a formal Investment Committee structure, the following notes apply.

Ideally the majority of members of the Investment Committee will bring strong investment and risk management capabilities. At the least they should be highly financially literate and be able to think about outcomes in terms of probabilities. Their domain knowledge should be maintained through an ongoing Board development program.

The Investment Committee's core responsibilities are to:

Make recommendations to the Board on:	<ul style="list-style-type: none"> ▪ investment policies and beliefs ▪ investment return and risk targets
Approve:	<ul style="list-style-type: none"> ▪ new asset classes and establish appropriate asset class benchmarks ▪ annual investment plans (where these exist) ▪ purchase and sale of investments beyond limits delegated to management ▪ allocations to external managers beyond limits delegated to management
Oversee and provide constructive challenge on:	<ul style="list-style-type: none"> ▪ investment decision-making frameworks and implementation ▪ fund performance and risk management

Note we do not recommend the Investment Committee makes decisions on the appointment or termination of individual managers (except in extraordinary circumstances). This is a function best left to management who ideally will have the necessary time and expertise to devote to thorough due diligence on these opportunities. The Investment Committee should focus instead on how a particular manager (or direct investment) selection decision is consistent with the organisation's investment beliefs and decision-making frameworks.

Creating clear decision rights

In order for an organisation to work effectively it is important to know the role that various individuals and committees fulfil with respect to particular decisions. For any decision there are up to four key steps:

- 1) **Input** – Contribute to the process of making a recommendation
- 2) **Advise** – Provide advice to the Recommender or directly to the Decider
- 3) **Recommend** – Provide a firm recommendation to the Decider
- 4) **Decide** – Take responsibility for final decision

Effective organisations clearly document these decision rights. A post-decision function is to oversee / monitor implementation. Who undertakes this function and the frequency with which they review decisions must also be documented.

Approval of the decision rights matrix resides with the Board. Delegations to management are generally to the CEO, Chief Investment Officer (CIO) or outsourced provider. There will usually be further delegated authorities flowing from the CEO down through the management team. These also need to be documented but are owned at the CEO, rather than Board level.

A sample (truncated) decision rights matrix might look like this:

	Input	Advise	Recommend	Decide	Oversee	Review frequency
Investment principles						
Investment beliefs	All	CIO	BIC	Board	Board	At least triennially
Investment Policies	MIC	CRO	BIC	Board	Board	At least triennially
Governance and organisation design						
CEO Appointment	HR	HR	HRC	Board	Board	Ongoing
Investment governance (authority & accountabilities)	MIC	CEO	BIC	Board	Board	Annually
Risk and return						
Setting the investment return objective	MIC	CIO	BIC	Board	BIC	At least triennially
Risk Appetite Statement	MIC	CIO/CRO	BIC	Board	BIC	At least triennially
Strategic Asset Allocation	MIC	-	CIO	BIC	BIC	At least triennially
Portfolio construction						
Target allocation (within prescribed ranges)	Investment team	MIC	-	CIO	MIC/BIC	Non calendar cycle
Review and set asset class benchmarks	Investment team	MIC	CIO	BIC	BIC	At least triennially
Manager selection / termination	Investment team	MIC	-	CIO	MIC/BIC	Non calendar cycle
Implementation						
Currency (and liability) hedge implementation	Investment team	-	-	CIO	MIC/BIC	Non calendar cycle
Manager implementation (rebalance, transition, etc.)	Investment team	-	-	CIO	MIC/BIC	Non calendar cycle
Manager fee negotiations	Investment team	-	-	CIO	CIO	Non calendar cycle

Definition of terms: MIC (Management Investment Committee), CIO (Chief Investment Officer), BIC (Board Investment Committee), CRO (Chief Risk Officer), HRC (Human Resources Committee), CEO (Chief Executive Officer)

Developing decision-making frameworks

Decision-making is greatly enhanced when an organisation has a well thought through set of principles to guide it. These decision-making frameworks should exist for each major area of activity.

An example of a decision-making framework might be one to cover manager selection / deselection decisions. Such a framework might address (amongst other things):

- Where will we source manager names from?
- How will we research managers? (Will we do it ourselves? Hire a consultant?)
- What are the key characteristics we will evaluate (e.g. people, process, performance)?
- What evaluation hurdle must a manager pass to be on our hire list?
- What events would trigger review / termination of a manager?

If these elements are clearly thought through and applied in a disciplined way then the organisation's decision-making will be much more consistent. Frameworks such as these also allow the Board (or Investment Committee) to understand how management approaches portfolio implementation and to challenge them on the consistency with which they apply the framework - we refer to this as a dual focus on **strategic dialogue** and **disciplined oversight**. There is a list of investment governance considerations under each of these headings in the box below.



Investment Committee Strategic Dialogue / Disciplined Oversight responsibilities

Strategic Dialogue

- **Mission and Beliefs.** Mission, goals and beliefs are clear and make sense. There is sufficient coverage of high level issues such as: risk and risk tolerance; how to integrate different time horizons; the organisation's wider responsibilities.
- **Delegation.** The operating model delegates responsibilities within well-defined limits, strong accountabilities of the Board and the executive, and a mandate that evolves through informal trust and discussion.
- **Performance.** There is clear specification of client and fund performance goals - including risk, time horizons and priorities - and service requirements.
- **Investment Model.** There is a detailed understanding of the investment framework and model, which reflect Beliefs and circumstances/resources/skills unique to the fund.
- **Strategy engagement.** There is high level engagement on the investment landscape and strategy. There is flexibility to adapt to new investment conditions and fund context.
- **Innovative agenda.** New investment content and context issues are considered. There is new thinking and learning being added. There is flexibility to discuss and adapt the investment/people/operating model.

Disciplined Oversight

- **Oversight.** The Investment Committee applies detailed oversight of implementation consistent with Beliefs and the Investment Model. Challenge is applied, not second guessing.
- **Engagement.** The executive are challenged on the quality of their investment thinking and theses, and coherence with the Investment Model. There are sounding-board discussions. Context is added.
- **Performance reporting/assessment.** Performance is assessed across multiple measures and time periods. The assessment has narrative on skill and context.
- **Investment skill.** The executive implements its mandate with skill. Risks and returns are managed within portfolios, applying comparative advantage in a mix of internal skills and external managers.

Making decisions in real time

To be effective in dynamic investment environments, asset owners need to have the decision-making flexibility to respond to market moves and new information in 'real time'. This is not to say that responses need to be instantaneous but rather that they should not need to wait for the next meeting in a Board or Committee cycle.

Subject to clearly specified decision rights and constraints, the Board should delegate as much time dependent decision-making as possible to the executive. It also must avoid micro managing and second guessing management decision-making. This requires building a substantial degree of trust in the competency of the executive. Ongoing Board education, clear decision-making frameworks and appropriately strategic dialogue are integral to achieving this.

Disciplined oversight

When decision-making is delegated to management or an outsourced provider, the Board (or Committee) has a critical oversight role. It is not there simply to rubber-stamp decisions made but rather to engage with management in a thoughtful way.

Board members need to combine their own personal and professional experience with their understanding of how the executive team (or outsourced provider) have said they will make decisions (i.e. their decision-making frameworks) to examine, and challenge where necessary, the consistency of decision-making. The beauty of decision-making frameworks is that they provide an objective anchor against which to consider decisions.

If the Board is not satisfied with the answers it gets when it does this it should request further information. If the executive is not managing in a way that is consistent with agreed decision-making frameworks then the Board will need to consider ways to address that. Commonly, the Board will hold the CEO to account for this. At the extreme, the Board can revoke delegations to management (or terminate the outsource arrangements).

To be clear: disciplined oversight is not an excuse for micro-management. The executive team are delegated oversight and must have freedom to execute those responsibilities. However, they must be accountable for that execution.



A case study on Decision Rights

Our client

Our client is a large, government entity, investment management organisation responsible for managing pension, insurance and sovereign wealth fund assets. It has a Board of directors (principally from financial services backgrounds), an Investment Committee and a medium-sized, in-house investment team.

Project scope

As part of a larger project on organisational design and governance, Willis Towers Watson worked with the client to clearly specify decision rights both between the client's Board and its executive team and between the client and its clients.

The process

The first step in our process was talk the client through the principles we apply to setting decision rights. The next step was to understand the wide array of investment decisions currently being made and where authority currently resided. If certain decision rights sat at levels that we consider less than optimal (usually if they were held at Board level) we needed to understand if there was a particular history behind that. We then proposed a 'straw' set of decision rights and worked the client through examples of how that would work in practice. We spent some time with the Board Investment Committee discussing what both a strategic dialogue and disciplined oversight look like in their context.

Outcome

The client has a comprehensive set of decision rights. The executive team are clear on those issues they can get on with on a day to day basis and those that require higher approval. The Board Investment Committee has a clear mandate involving some decision-making and some strategic dialogue / disciplined oversight responsibilities. The Board concentrates just on the highest level strategic issues.

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