Willis Towers Watson PODfolio_episode_6_
Asset owners: How to make a good decisions

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JESS MELVILLE: Strong governance relative to, you know, a simple, low-cost reference portfolio can add value to the tune of around 100 basis points.

NARRATOR: Welcome to The PODfolio, Willis Towers Watson's investment podcast series where we'll give you an update on the latest developments across global markets and talk to expert guests on hot topics that matter to institutional investors and their portfolio.

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LOK MA: Hi, and welcome to The PODfolio podcast. I'm your host, Lok Ma. And today we're very pleased to have Jess Melville is our guest. So hello, and welcome, Jess.

JESS MELVILLE: Hi, [INAUDIBLE]. Thanks for having me.

LOK MA: Jess is head of strategic advisory based in Australia, and she works with a range of clients, including some of these big super funds which I'm very excited to hear a bit more about. Now, those of you who have listened in to the last couple of podcasts, you will have heard some discussions around how the asset managers have been coping in this stressed environment that we're having. And today we're going to turn our attention to the asset owners and talk about how they're doing.

And I think there's probably an even greater variety of asset owners compared to asset managers. So different countries have different structures. Take pension funds as an example. Here in the UK, we have a trustee-based system. And elsewhere-- for example, in the US-- you have more kind of corporate people, finance directors making these kinds of investment decisions. And in various places, you could have a delegation model or a consolidation model like you might see in Australia where you have these big organizations run the assets for lots and lots of members. So everybody's different, but then everybody's also the same in the sense of dealing with these new challenges, like working remotely and trying to make decisions via web meetings, and so on and so forth, which makes all of this all very fascinating-- for me, anyway.

So Jess, first of all, you're head of Strategic Advisory. Can you just give us a quick sense at the beginning of what it is that your role entails?

JESS MELVILLE: Yeah, sure. So we largely focus on governance. And one of the things that we often find is that when you're trying to improve governance, it leads to some chunky strategic issues, like have we got the right team, does our business model support the way we want to invest, and how can product design be improved? So for that reason, we deal with a lot of strategic issues-- people model, business model, et cetera. So for that reason, my is called the Strategic Advisory team.

LOK MA: So are people-- the asset owners generally, are they getting things done at the moment, or are things grinding to a halt just when you really need to be reacting to market events?

JESS MELVILLE: Yeah, certainly. So they-- surprisingly, they're doing surprisingly well, I would say. And it's-- I mean, it's quite remarkable in this environment given if we take a step back, we've had some of the biggest market falls happening over a short period of time. And I think the short period of time has been the challenge. And this has all happened at the time that we've all just had to move to working remotely almost instantaneously, so the challenge of getting people the right access, the right equipment, et cetera, and just having to make some really big investment decisions all around that same time.

So I guess the big question is, how are they managing to get things done? And I'd say that the thing that they're doing really well is they're adapting and prioritizing, so prioritizing the most important things and getting those things done first. So for the asset owners, it's making sure that they're doing the rebalancing that they need to do and then moving into, do they need to de-risk their portfolios?

There's been a lot of focus in Australia on unlisted real assets and whether they need to write down valuations. And on top of that, there's been a bit of a stress on liquidity and having to raise liquidity to fund redemptions. So lots of big decisions that need to be made. And so the asset owners really adapting to that, so focusing resources on those most important things, and largely, having to meet more frequently to get those investment decisions made.

LOK MA: So that's good to hear. So now we're talking about making investment decisions. And really, we're talking about making good decisions. So let's think about an asset owner. Typically a group of people in an investment committee say-- so Jess, I'm going to describe a couple of situations which hopefully lots of people will recognize. And I just want to get your take on some of these.

So the first one is what I would describe as the loudest voices in the room. And hopefully, lots of people will recognize this. So this is where you have one or two members of that investment committee who may or may not be experts in the topic we're talking about, but they're very vocal and quite dominant characters. So right at the beginning of the discussion, they set up some pretty strong views of how they see things. And chances are, more often than not, that the eventual decision tends to go that way. So what was your take on that? I mean, is there a way of avoiding meetings being dominated by the most vocal characters?

JESS MELVILLE: Yep, absolutely. Our Thinking Ahead Institute has done some great work. And one tool kit that I love to pull up is the Better Decision Tool Kit because it gives you some tips and tools to draw upon. So in that situation where you've got a loudest voice in the room and everything falling into line behind that person-- that person's voice or their opinion, you know, it's really important that first and foremost, you have a skillful meeting chair that can manage when those views are expressed and also helps to include different, perhaps alternative viewpoints. So managing the team dynamics is really important, but often easier said than done, right?

The other things that I would point to are a little bit more into that toolkit. So one of the things you can do beforehand is pre-poll and understand what are the viewpoints that are going to come into your meeting room. Actually doing some voting through some voting software is one way of saying to people what issues are important to you and what issues would you like us to really delve into. A softer way of approaching that is to have the IC chair actually talking to the people that will be coming to the meeting and say, look, we set the agenda around, and what are your thoughts on this issue or that issue? And just trying to raise up some of those issues.

And extending that thought on using voting tools, you can actually also use those tools in the meeting itself. So I've seen it done really nicely where you go around and talk about an issue, and you vote on what people think. And so while it might feel like in the room, it is that dominant person's view that's going to pervade, actually, when you do the voting, you realize that it's actually closer to 50/50 or actually goes the other way. And using that as a platform to then discuss, well, what other-- what is driving those different viewpoints? So it's important that-- you know, you want to manage the dynamic in the room, but ultimately, what you're looking for is that the decision isn't dominated by that dominant voice.

LOK MA: Yeah. And I want to talk about the flip side of that loudest voice in the room phenomenon as well. And I think it's just as important. So on a committee or a board, quite often, again, you have a minority of members who don't seem to have much of an opinion about most issues. Obviously, again, a great thing-- and you talked about how voting might draw out some of those opinions. Is there a danger, though, that you're forcing people to come up with a pretty much random view just for the sake of being asked to contribute?

JESS MELVILLE: Yeah. I often refer to them as the stoic committee member. So you don't exactly know why they're quiet. Is it because they disagree, or they just don't know? And it's important to realize that there are some key issues and actions that are going to be taken by your trustee board or your investment committee that do need to get some form of buy-in around the table.

And so for those people, it's-- you know, it is really important to understand why they're not expressing a view. So is it not understanding the issues, or is it that perhaps the meeting conditions haven't permitted them to ask for more information, or they just haven't felt safe to express an alternate viewpoint? So that can also come back to those pre-meeting conversations that the chair can have, and also, that pre-polling that can help flesh out some of those views. And it might not be that person that raises it at the meeting, but it is the chair that it's really their responsibility to raise those issues.

And one example that I've seen that works really well that helps to balance both those issues that you've highlighted about the loudest voice in the room versus the really quiet and silent person-- one thing that I've seen done really well is the IC chair spends a lot of time beforehand, once the agenda has gone out and all the materials have gone out, a couple of days before the meeting, actually phoning around the committee members and saying, right, well, I think these are the most important issues. And I think we should be discussing this, this, and this. And what do you think?

And basically finessing the timing of the meetings to focus on the most important areas, but then going one step further and saying, look, I'm very happy with that. Out of the seven agenda items, we're going to focus on three areas. And I'm actually going to go around the room and ask you to just give me a couple of minutes on what you think on these issues. So people don't feel like they're put on the spot, and they've got a bit of time to pull together their thoughts on what they think of a particular issue. So I think that one works really well.

LOK MA: Yeah. And I think if every IC chair did that, I think you would get better decisions get made, honestly. And one more hypothetical situation for you, Jess, and this one is pretty close to my heart. I call it a bias towards the status quo, so this fear of making a change in an investment strategy. Because if that doesn't go well, then it looks like you personally caused that bad thing to happen. And we know that's not logical, because if you don't make a change, something bad could also happen. But it just somehow feels less like that's on you.

Again, I said not logical, but psychologically, I think lots of decision-making bodies are kind of paralyzed by their sort of status quo bias. So how do you go about overcoming that fear of making a change?

JESS MELVILLE: Yeah, that's very close to my heart as well. And for those of you not familiar with the Australian market, particularly amongst the super funds, it's an incredibly competitive environment. And so it leads to this-- I guess I'd describe it as a peer awareness that people are-- there's so much data that is published on what your competitors are doing, monthly performance data, asset allocation data. And it leads to a sort of herd mentality.

But I guess if you take a step back, that's something that does pervade almost every market that we operate in. Because it is easy and safe to say, oh, look, we've always done it this way. Everyone else who's like us does it this way, so I don't want to change it. And I think with some of the best funds that we've worked with, they turn that statement on its head. And they say, well, how can we learn from what other funds are doing and help use that to help challenge the way that we do things?

So one example of a fund that we worked with was-- you know, they were looking at their return objective and saying, look, this is not sustainable. There are a number of reasons why we have to change our strategy. But we-- you know, we have the status quo bias, as you described it. So we helped them talk directly to over a dozen leading asset owners around the world about how they go about achieving their return objectives. And I can tell you that there are at least a dozen different approaches that came back to them. They were using everything from active to passive, fundamental, smart beta, dynamic tilting, the whole works.

But it helped this fund to realize that there are many different ways of changing their objectives. And ultimately, they did adopt some of those different ideas learned from around the world to help change their objectives. So I guess my key takeout from that is, you know, challenge yourself to understand what best practices are out there.

LOK MA: So you suggest-- you mentioned a bit about the Australian super funds. And you know, obviously, I've heard of them. I know they're generally seen as amongst the best of the best of asset owners. And can you just give us a quick overview of what these funds are?

JESS MELVILLE: Yeah, certainly. So the super fund system in Australia has been backed by a government compulsory contribution since the 1980s. And so it is about a $3-trillion system in Australian dollars. So some of the larger ones are well and truly over $100 billion in assets under management. And they've been increasingly professionalizing the way they go about managing assets on behalf of their members.

So their increasing scale allows them to invest in more complex asset classes and strategies. And it's fairly commonplace for certainly the largest asset owners to have some form of internalized investment management team, whether that's managing assets directly or whether that's a professional team that is making the investment decisions.

LOK MA: Yeah. And so obviously, a lot of scale, lots of professional experts in different areas. Just thinking in terms of their decision-making process, is there anything that you could draw from that the rest of us mortals can maybe learn a bit from?

JESS MELVILLE: Yeah. I can give you-- I'll try and give you the five-minute version. So the-- a couple of things that really distinguish them, and I think this has really come to light as we've been in this crisis mode, the having to make lots of pretty big decisions in a short period of time and ultimately having a big impact on outcomes. I focus on three things. And that would be, firstly, they have generally got really strong delegations from their governing body. So they might be overseen by a board and an investment committee, but the investment team internally has good delegations. And furthermore, everyone is very clear on the role that they play in making those investment decisions.

So I guess one thing that's very close to our hearts is that they have very strong investment beliefs, those investment beliefs guide the investment decisions. And that's really important in times like this when there's huge amounts of uncertainty, that beliefs help to guide us through that. Secondly, I'd say that they use their time and resources effectively. And you know, I know I've just said that they do have well-developed internal teams, but, you know, no one has infinite resources. And so one thing that really-- really distinguishes them is that they do focus on the stuff that is important at any one time, and particularly the stuff that's going to impact their investment outcomes.

And finally, I'd say that, you know, as we've been talking before about investment committee dynamics, these asset owners do a good job of bringing it together well. So we've talked a lot with some of the asset owners in recent times about, well, how are you coping with the virtual world of making decisions? And investment committees and trustee meetings have long been associated with a bunch of people sitting around a table. So what does that feel like when you're sitting over the laptop on a Zoom conference call?

But I guess, perhaps not surprisingly, the virtual IC best practice has a lot to-- a lot in common with its face-to-face cousin, which is having deliberate structuring of the meeting before, during, and after. What do I mean by that? Well, you know, having very considered, structured materials going out beforehand coupled with really good discussions around what issues need to be covered.

During the meeting, having strong chairmanship-- so the challenge of managing those dominant voices around the room and also fleshing out the quieter ones is almost all the more difficult over-- you know, over the conference call. So effective chairmanship is really important there. But it actually makes it easier to use live polling as well. And then afterwards, making sure that you're getting feedback on the effectiveness of those meetings and also making sure that action items are followed up on, and so on. So those are some of the-- I guess, some of the best-practice approaches to decision making.

LOK MA: So that all sounds very impressive, and I think, actually, quite achievable to the rest of us. Do you see other clients of yours do this kind of thing, or is there something that's holding them back from following these-- what seem to be very sensible practices?

JESS MELVILLE: I think you're right you're absolutely right there, [INAUDIBLE], that a lot of those principles can apply to funds of any size, and ultimately of any type. It's not just super funds that this applies to. So if you think it through the strong delegations and everyone being very clear on the role they play, that can be done by most funds. Allocating time and resources effectively and focusing on where you're going to make the most impact on your investment outcomes, again, can be done by anyone.

And then bring it together well-- you know, all the stuff that we've talked about to do with good meeting practice, ultimately, can be done anywhere, anytime. We've done a lot of work within manager research in my past career making sure that we did adopt some of these practices. So there's really ideas out there for anyone to adopt.

LOK MA: Yeah. And of course, the proof in the pie is in the-- I still don't know what the saying is. The proof in the pie is that they're eating it--

JESS MELVILLE: It's the proof in the pudding.

LOK MA: The proof in the pudding is how it tastes, or--

JESS MELVILLE: That's what we say in Australia.

LOK MA: Anyway, so do you see evidence that the asset owners that follow these good practices actually get good-- better results?

JESS MELVILLE: Well, I guess the proof is in the long-term results. And you know, the long term results have been strong for these asset owners against their objectives. But more to the point, does strong governance get better results is probably the more pertinent question. Because you know, while we work with a lot of the super funds, we don't work with all of them.

So if I were to take a step back and say does strong governance get better results, I would say definitely, yes. And that is true on a global scale. So we do a lot of work benchmarking global best practice in governance. And there's a lot of detailed analysis that goes into it. But the empirical observation is that strong governance relative to a simple, low-cost reference portfolio can add value to the tune of around 100 basis points. So I think that's a pretty compelling result there.

LOK MA: And you know, it shouldn't really be a surprise that if you have loads of very clever people, full-time professionals and experts in their field making all these decisions, they will, on average, do better than other people who are not in that happy, privileged position. But a lot of things these super funds and the like do are pretty complicated.

So if you're not in that position, is there actually an argument for sticking to what you know? So we know that diversifying assets and going into different areas or using more sophisticated structures, maybe derivatives, are all very sensible things. But how do you balance that against the risk of getting it wrong because you are going out on a limb, and you're not an expert in every single one of these things?

JESS MELVILLE: Yeah. Yeah, I think it's a really-- I mean, it's very topical right now. It's something that is probably confronting many people. I mean, you've had David and Craig on your series talking about what's our economic outlook and the possibility of having V-shaped and U-shaped and L-shaped scenarios. So what do you do? What are the options available to you if complexity is going to be a challenge?

I think the-- my response to that is that, yes, we should always stick to the things that we know. But if you're a trustee or an asset owner, you're in a position where you're trying to achieve an outcome for your members and your beneficiaries. So you shouldn't let what you do know be a barrier to achieving those objectives. And what do I mean by that?

Well, look, we know adding diversity is a key strategy to holding a portfolio that is robust to a number of the outcomes that are likely to happen. So it is important that governance is not a barrier to holding that portfolio. And if it is, then the advice there is to look to external partners to help out there.

LOK MA: Yeah. And one last question then, Jess. So we've been in lockdown-- wherever we're listening to this from, we've been in lockdown for a number of weeks and months now. But it does seem like there is probably a light coming at the end of the tunnel. We can see our way out of this. So do you see any positive changes in the way that assets owners-- asset owners are going to operate once we come out of this period of lockdown?

JESS MELVILLE: Yeah, yeah. Isn't it nice to think about what the light at the end of the tunnel looks like? So yeah, I think there are some really nice green shoots that have come out of conversations that I've had and also read about. So, I mean, starting out with a more joined-up approach to thinking across the portfolios-- so I was talking to one of my clients probably about two weeks into the lockdown.

And I said, how are you going as a team? And he said, you know what? We're doing really, really well. And better still, we talk to each other more than we ever did when we were in the office, which was really funny. They just worked in their own asset classes, and they didn't have a lot of reason to collaborate, essentially.

So I'd like to think that-- I mean, the reason that they were talking was that they had some immediate actions to take. They were considering whether to take risk out of the portfolio, and they also had some liquidity requirements to meet. But I think that that was really nice-- a nice silver lining in all of that.

So I'd like to say that in the longer term, we're going to end up with some more joined-up thinking and more coordinated action that kind of endures past this lockdown. And making sure that that thinking and action focuses on the overall portfolio objectives, which is what we call the total portfolio approach. And we genuinely think that that will lead to stronger investment outcomes.

Secondly, I think that one thing that's really struck me is that there's just been such a huge focus on employees. And I think that's true within Willis Towers Watson as well as across all the asset owners that there's been this unprecedented focus on the welfare of our employees, their mental well-being, stress. And I think that's just something that shouldn't mean revert. I read an article from a CEO of one of our clients, actually. And she was saying, look, I'm really conscious that we're all working from home, and we're probably just working longer hours than we usually would.

So one thing that she did across her organization was make sure that everyone had an hour in their diaries at lunchtime just to take a break. And I thought that's, like-- that's a really nice thing to do.

LOK MA: [INAUDIBLE]

JESS MELVILLE: I know. I know. I mean, to do what? To walk around the backyard. But it's just a really nice thought that we should all just take a break, because you would've taken a break in the office as well. So I think going forward, I'd like to think that there's just a stronger appreciation for each individual's context and greater adoption of flexible work practices and just generally more focus on culture.

And finally, I think that one thing that's-- the other thing that's really struck me about just everything that's been happening in the world is that everyone appreciates our interconnectedness as a society and our vulnerabilities when one part of the system is impacted. So I'd like to think that there will be a continued focus on those bigger-picture issues like sustainability and climate change.

LOK MA: Well, that's a lovely note to end on, Jess. So thanks very much, Jess, and we hope the rest of you enjoyed listening to this as well. So this is probably the third in a series of podcasts looking at how decision-making is done at the asset managers and the asset owners as well. We'd like to follow up with more discussions along those lines, particularly around I&D, inclusion and diversity.

So how do decision-making bodies make sure they have a rounded collection of views looking at the problem from different angles? And for that one, I'd really like to not just do the "isn't diversity great" kind of discussion. I want to go into some of these more interesting and controversial areas. So please do look out for that. And in the meantime, do you take care of yourselves, and thank you very much for listening.

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