Evaluating Investment Managers

October 2nd, 2017

Presented by: Dan Smereck, Managing Director & Principal
Session Introduction

- **Investment income** is a cornerstone to the risk transfer business model, and maximizing investment income can mean the difference between remaining competitive or losing members to aggressive pricing.

- So, how do you know you are **getting the most** out of your portfolio and your investment manager?

- Hear from pools asking the same questions, and learn about common assessment strategies and helpful metrics that differentiate one investment manager from another:
  - Lisa Duquette, Executive Director, SchoolCare
  - Melissa Perreault, Associate Executive Director, SchoolCare
  - Jeff Nickey, Deputy Managing Director, VMLIP
Investment risk that you are most concerned about?

Please select the investment risk that you are MOST concerned about. (%)

- **Low Yields**
  - Global: 35%
  - Americas: 29%
  - EMEA: 35%
  - Asia Pacific: 41%

- **Credit Quality Deterioration**
  - Global: 21%
  - Americas: 14%
  - EMEA: 28%
  - Asia Pacific: 43%

- **Rising Interest Rates**
  - Global: 18%
  - Americas: 17%
  - EMEA: 18%
  - Asia Pacific: 21%

- **Equity Market Volatility**
  - Global: 12%
  - Americas: 12%
  - EMEA: 10%
  - Asia Pacific: 14%

- **Credit Spread Widening**
  - Global: 8%
  - Americas: 6%
  - EMEA: 9%
  - Asia Pacific: 13%

- **Liquidity Risk**
  - Global: 7%
  - Americas: 5%
  - EMEA: 8%
  - Asia Pacific: 5%

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How do these risks rank for 2018 and 2019?

Source: GSAM Insurance Asset Management Insurance Survey – April 2017
Awash In Investment Managers – Option Anxiety

● Separate Account Managers (Informa/PSN Database)
  ○ Domestic Fixed Income = 3,756
    ➢ Domestic Core Fixed Income = 859

● Mutual Funds - Equity (Morningstar)
  ○ U.S. Equity: Large/Mid/Small Cap = 2,285
    ➢ Large Cap = 1,233
    ➢ Mid Cap = 459
    ➢ Small Cap = 593
  ○ International Developed Equity: Large/Mid/Small = 539
  ○ International Emerging Equity = 240
How much surplus does your organization need to:
- Meet its members’ needs;
- Manage the risk exposures it is comfortable taking;
- Maintain a cushion for contingencies.

Does your investment manager understand your business?
- Risk Tolerance, Liquidity Needs, Custom Reporting, etc.
Strong investment results require a strong investment process. This goes beyond choosing the right investment manager.
Investment Performance Objectives

Where do you fall on this objective continuum and why?

- Book yield 'or' Income Only
- Constrained total return
- Most Risk Pools & Insurers
- Total return
Risk Asset Allocation - % of Surplus / Net Position

<table>
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<tr>
<th>RA % of Surplus</th>
<th>Max</th>
<th>Min</th>
<th>Median</th>
<th>Average</th>
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<td>66.4%</td>
<td>0.0%</td>
<td>23.9%</td>
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</table>

Risk Asset Allocation As % of Surplus / Net Position
Investment Manager Evaluation – The Four Ps

➢ People

➢ Philosophy

➢ Process

➢ Performance
Investment Manager Evaluation – PEOPLE

- Corporate structure
- Organization
- Insurance/Risk Pooling experience/expertise
- Tenure, experience and stability of team
- Compensation
- Succession
- Client service structure
Investment Manager Evaluation – PHILOSOPHY

➢ Key investment beliefs
➢ How manager adds value
➢ Bottom up/top down
➢ Competitive advantage/Value Proposition
Investment Manager Evaluation – PROCESS

➢ Understandable
➢ Intuitive
➢ Repeatable
➢ Unique
➢ Methodical
➢ Risk controlled
Investment Manager Evaluation – PERFORMANCE

➢ Adjusted for risk
➢ Adjusted for fees
➢ Consistency
➢ Rankings vs. peers
➢ Upside/downside
➢ Consistent with philosophy & process
➢ Attribution
Sample Manager Peer Analysis Report

Total Fixed Income Portfolio vs PSN Investment Grade Fixed Income Interm Gross: Return
January 2005 - December 2014 (not annualized if less than 1 year)

- Green: Barclay's US Aggregate Bond Index
- Red: Total Fixed Income
- Diamond: Total Fixed Income Benchmark
- Light Gray: 5th to 25th Percentile
- Medium Gray: 25th Percentile to Median
- Dark Gray: Median to 75th Percentile
- Black: 75th to 95th Percentile
Investment Manager Selection Process – “Going to RFP”

- Initial List of Candidates
  - GIGO
- Questionnaire
  - Core vs. Client Specific
- Evaluation
- Ranking & Recommendation
  - Objective vs. Subjective
- Interview & Selection
- Transition
## Objective vs. Subjective Evaluation – Pugh Matrix Approach

**Legend:**

- -- Disadvantage compared to key criteria (weighting of 2X’s as bad)
- - Disadvantage compared to key criteria (weighting of 1X as bad)
  s No advantage / disadvantage to the solution compared to key criteria
+ Better than the key criteria (weighting of 1X’s better)
++ Better than the key criteria (weighting of 2X’s better)

### Key Criteria:

<table>
<thead>
<tr>
<th>Key Criteria</th>
<th>Importance Rating</th>
<th>Current Manager #1</th>
<th>Current Manager #2</th>
<th>Manager #1</th>
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<th>Manager #3</th>
<th>Manager #4</th>
<th>Manager #5</th>
<th>Manager #6</th>
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<td>3 Offers Full Investment Accounting Services</td>
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<td>4b Relative Investment Performance (Risk Adjusted - Sharpe Ratio)</td>
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<td>5 Investment Management Fees (including impact of Inv. Acctng costs)</td>
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<td>6 Insurance expertise (management, communication, people skills, knowledge, experience)</td>
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<td>7 Insurance Analytics, Tools and Resources</td>
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<td>8 Investment Process (managing portfolio / portfolio turnover) - rigor</td>
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<td>9 Credit Evaluation Process</td>
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<td>10 Data processing capability (timely report generation, quality of reports, customization, vendor interface)</td>
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<td>11 Frequency of communication / involvement on governance committees</td>
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<td>12 Cultural/Strategic Fit (Prior experience with SAA - How will the investment process and culture of the investment firm mesh with our organization?)</td>
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<td>13 Breadth of services (ability to grow with company, asset class services)</td>
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<td>15 Potential for Conflicts of Interest</td>
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### Potential Finalist Recommendations

Manager #3
Manager #2
Manager #4
Manager #5
Manager #6
Case #1: Manager Search with Manager Change

- Pool Background
- Situational Background
- RFP Process Highlights/Lowlights
- Rationale for Change/No Change
- Words of Wisdom?
Case #2: Manager Search with Incumbent Retained

➢ Pool Background
➢ Situational Background
➢ RFP Process Highlights/Lowlights
➢ Rationale for Change/No Change
➢ Words of Wisdom?