



Investment Consulting

Fund Manager Selection 2014

Common Pitfalls of RFPs

PPCmetrics AG

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Zurich, September 24th, 2014

Important Role of Asset Managers



Asset Managers perform an important intermediary role for investors and must therefore be selected carefully!

Importance of Manager Selection for Clients

Studie	Datensatz und Zeitperiode	Einfluss der Anlagestrategie auf das Portfolio	
		Rendite*	Risiko**
Brinson, Hood, Beebower (1986)	91 US Pensionskassen (1974 - 1983)	112%	94%
Brinson, Singer, Beebower (1991)	82 US Pensionskassen (1978 - 1987)	101%	92%
Ibbotson, Kaplan (2000)	58 US Pensionskassen (1993 - 1997)	99%	88%
	94 US Anlagefonds (1988 - 1998)	104%	81%
Vanguard (2003)	420 US Anlagefonds (1962 - 2001)	114%	77%
Drobetz, Köhler (2002)	51 CH/D Anlagefonds (min. 1995 - 2001)	134%	83%
PPCmetrics (2014)	44 CH Pensionskassen (2011 - 2014)	102%	96%

However, manager selection is not the most important task of an investor.

Difficult Manager Selection Task

Performance of Recommended and Not Recommended Products

The table shows the performance of portfolios of US equity actively managed products recommended by the investment advisors in our sample during the 1999 to 2011 period. Portfolios analyzed are the portfolio of all recommended products, the portfolio of the top 50% most recommended products and the portfolio of the bottom 50% recommended products. The table also shows the performance of institutional products not recommended by any of the advisors. Performance is measured using raw returns, returns in excess of a benchmark chosen to match the product style and market capitalization, and one, three and four factor alphas (corresponding to CAPM, the Fama-French three factor model and Fama-French-Carhart model). Excess returns and alphas are expressed in % per year. These statistics are computed on monthly returns and annualized by multiplying returns and alphas times twelve. All reported figures are gross of fees. The first part of the table shows the results for equally weighted portfolios of products whereas the second part of the table shows the same statistics for portfolios of products weighted using total net assets at the end of the previous year. t-statistics based on standard errors, robust to conditional heteroscedasticity and serial correlation of up to two lags as in Newey and West (1987), are reported in parentheses.

	Avg. Returns	Avg. Excess Ret. over Benchmark	One Factor Alpha	Three Factor Alpha	Four Factor Alpha
Recommended Products	7.13% (1.40)	1.25% (2.14)**	2.43% (2.63)***	1.14% (1.42)	1.14% (1.36)
Equally Weighted					
Top Recommended Products	6.82% (1.30)	1.15% (1.97)**	2.13% (2.21)**	0.90% (1.15)	0.91% (1.13)
Bottom Recommended Products	8.58% (1.58)	1.70% (2.70)***	3.85% (3.07)***	2.31% (2.22)**	2.25% (2.12)**
Not Recommended Products	8.13% (1.59)	2.35% (3.19)***	3.52% (3.30)***	2.00% (2.33)**	2.00% (2.33)**
Recommended - Not Recommended Products	-1.00% (2.01)**	-1.10% (-3.03)***	-1.09% (2.49)**	-0.85% (2.31)**	-0.86% (2.33)**

Jenkinson, Jones, Martinez (2014): "Picking winners? Investment consultants' recommendations of fund managers".

Finding "tomorrows winners" is next to impossible.

- Best Practice demands a **structured selection** process.
 - A mandate award without competition amongst bidders is likely to be at the disadvantage to the pension plan members.
- The award must be based on **clear selection criteria**.
 - The result of the tender process is likely to be known in the market and may thus be subject to reputational risks / litigation.
- The manager selection process must be **highly efficient**.
 - The costs of the selection (search costs) are in any case ultimately paid by the investor.

Public vs. non-public tender process

“non - public”

Open List (no participation fee)



Screens / Ranking

Short List



RFP

Beauty Contest

Mandate Award

“public”

Public Announcement (Contract Notice)



Pre-Qualification

Qualified List

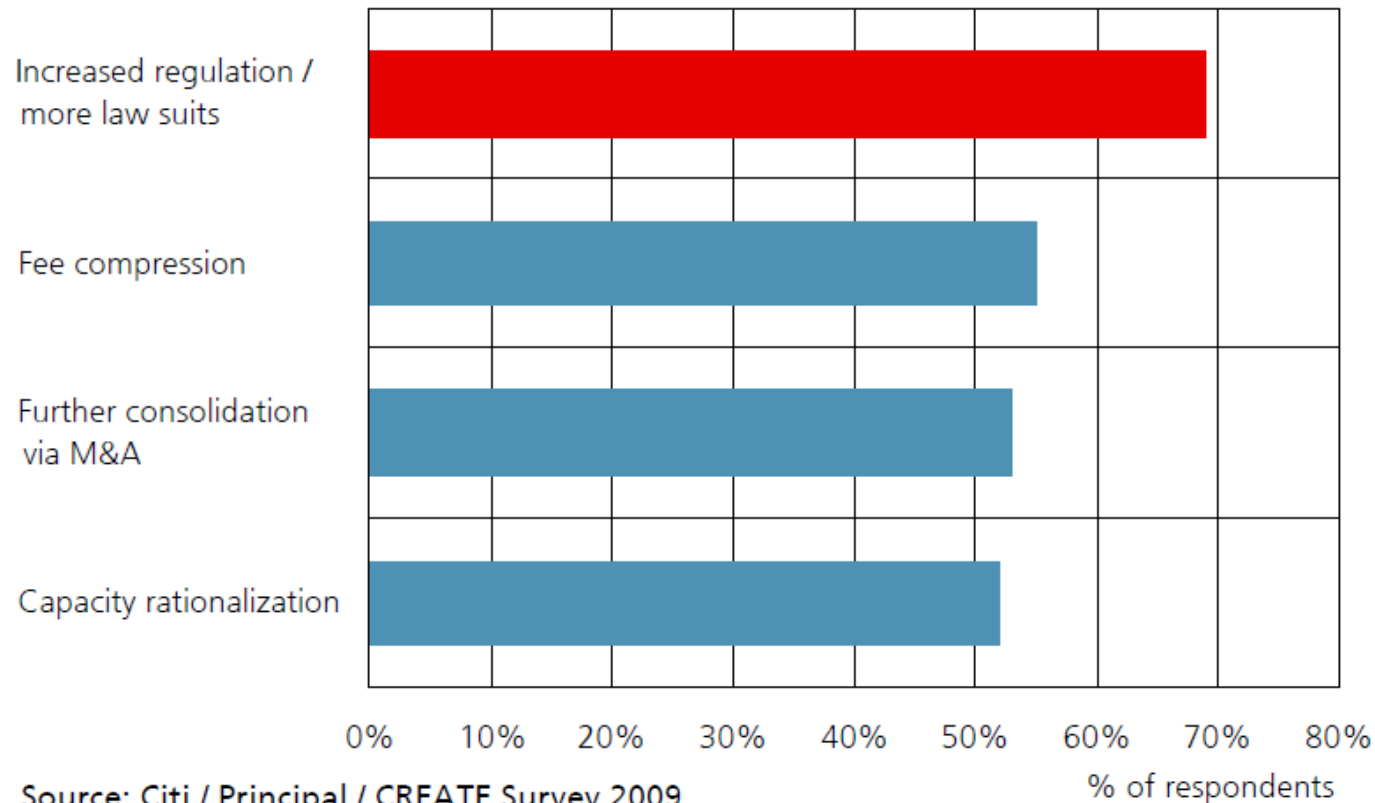


Tender

Clarification Meetings

Mandate Award

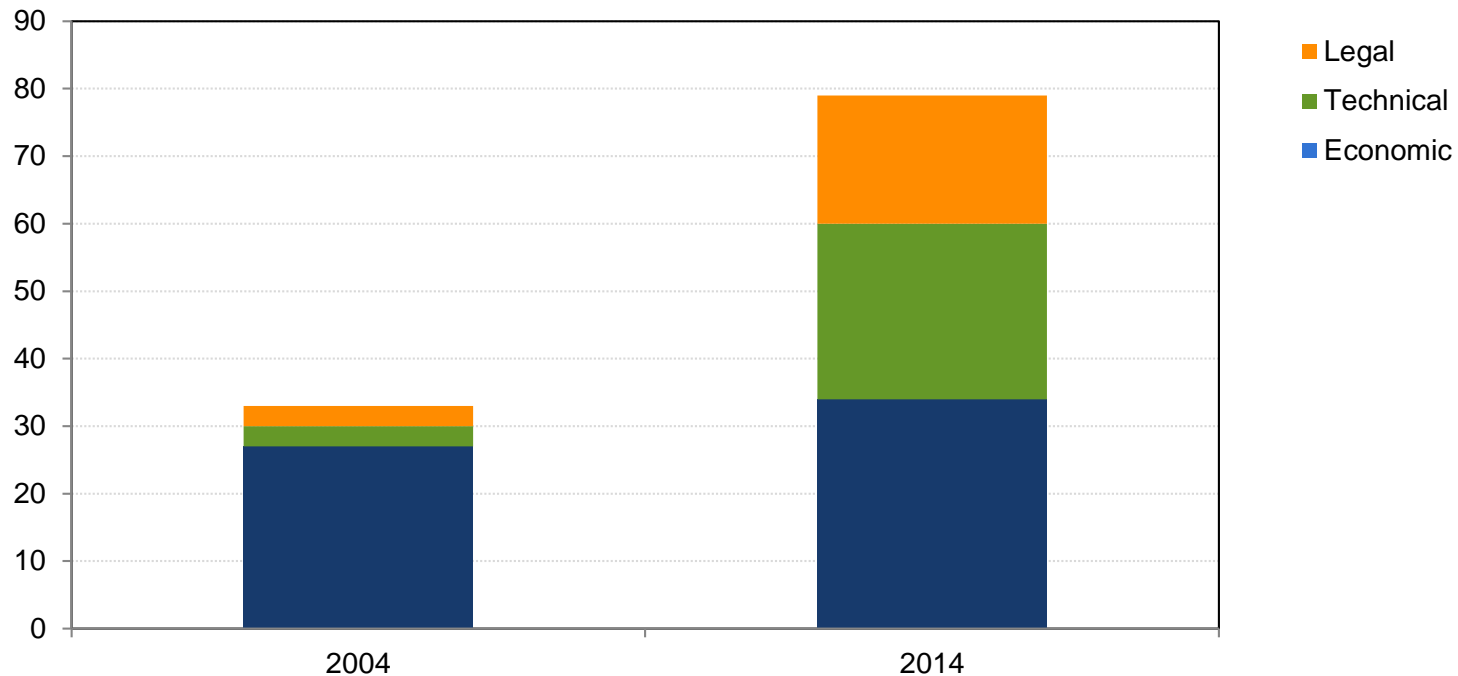
Which of the structural changes in asset management will have the biggest impact over the next 3 years?



Source: Citi / Principal / CREATE Survey 2009
Global survey with 225 asset managers and pension funds

Changes in RFPs over Time

Number of Questions in Global Equity RFP



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Advances in technology paired with tightened compliance rules has created a complex business environment.

Quality Standards

Art. 48f BVV 2

Prohibited Transactions

*Art. 53a lit. a BVG;
Art. 48j BVV 2*

Conflicts of Interest

*Art. 51b Abs. 2 BVG;
Art. 48h, Art. 48l Abs. 1 BVV 2*

Transparency

Art. 48l BVV 2

Inducements

*Art. 53a lit. b BVG;
Art. 48k BVV 2*

- **Careful selection of RFP questions**, internal quality controls.
- Questions are discussed in **100+ client meetings** p.a.
- Our RFP questions are answered and evaluated 400 - 1'000+ times per year.
- Formal **Q&A** in all public tenders.
- **Internal feedback loop** for unclear questions.
- **Annual reviews** with randomly selected asset managers.

RFP design and evaluation requires extensive „real life“ testing and strict quality controls!

- Investment concepts from the 1950s - 1970s have gained widespread credence and gained broad popularity. The extent to which **new investment concepts** can be introduced into practice is not always clear.
- Increased regulation of entire value chain lead to an **unprecedented complexity of business**, raises market entry barriers for global competitors and offered opportunities for local players.
- Increase in **formal errors in RFPs**, such as incomplete or missing answers.

Formal errors have increased in number.

- **Full disclosure:** questions **left blank** receive the lowest possible score!
 - e.g. high outflow of client money is still better than no answer
 - always state reference clients (no “provided at a later stage”)
- **Full transparency:** questions **answered unclear** or ambiguous get point deductions!
 - try to avoid references to other (lengthy) answers
 - clearly mention any simulated performance data

Be aware of increasing importance of RFPs!

- Manager selection is not the most important task for investor.
- Governance requirements have strongly increased and are likely to continue to do so.
- Technical and Legal (regulation) aspects have strongly increased and are likely to continue to do so.
- The “future” of manager selection is a structured process in line with public procurement.
- **Be aware of increasing importance of RFPs and formal errors!**

Thank you!



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