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Pension Funds, Governance, and Organization Design



A Research Progress Report
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Pension Fund Governance Research: A Brief History

- Peter Drucker, *The Unseen Revolution*, 1976
- Keith Ambachtsheer, *Pension Funds and the Bottom Line*, 1985
- O'Barr and Conley, *Folly and Fortune*, 1992
- Ambachtsheer, Boice, Ezra, McLaughlin, *In Search of Pension Fund Excellence*, 1996
- Ambachtsheer, Capelle, Scheibelhut, *Improving Pension Fund Performance*, 1998
- Ronald Capelle, *Improving Pension Fund Performance: Organization Design and Governance*, ICPM Colloquium, 2004

The O'Barr - Conley 'Bombshell'

- *After reading our book, you'll feel a little bit like the airline passenger who peeked into a cockpit at 30,000 feet and found there was no one in there.*

O'Barr and Conley
Folly and Fortune, 1992

Three Key O'Barr - Conley Findings

- Organizational structures of pension funds seem to be historical accidents
- Common cultural themes seem to be responsibility-shifting and blame-deflection
- Strong personal relationships with consultants and investment managers seen to be a top priority

O'Barr and Conley
Folly and Fortune, 1992

A More Positive Approach

- Estimated median cost of excellence shortfall by 50 senior pension fund executives: 66 basis points per annum
- Cited reasons:
 - Poor decision processes 98%
 - Inadequate resources 48%
 - Lack of focus or clear mission 42%

Ambachtsheer, Boice, Ezra, McLaughlin
In Search of Pension Fund Excellence, 1996

A More Ambitious Approach

- Estimated 'strong – weak' CEO score spread in performance among 80 USA and Canadian pension funds was about 1% per annum over 1993 – 1996 period.

Ambachtsheer, Capelle, Scheibelhut
Improving Pension Fund Performance, 1998

1993 – 1996 Performance Drivers in Pension Funds

- Clarity about pension deal and risk-bearing
- Clarity about board and executive responsibilities
- Clarity about board composition and skill set
- Willingness to evaluate both executive and own effectiveness
- High trust level

Ambachtsheer, Capelle, Scheibelhut
Improving Pension Fund Performance, 1998

ICPM- Sponsored Research

Pension Fund Governance and Organization Design

The Research Plan From Here

- Perform further analysis on 1997 CEO Survey and pension fund performance
- Repeat 1997 CEO Survey in 2005
- Have CEO perceptions of strengths and weaknesses in their governance and management practices changed?
- Can we discover additional insights into the drivers of investment performance?

The Data Sets

- 45 Statements:
 - governance (16)
 - management (12)
 - operations (17)
- Six-point Likert scale
 - 6 = total agreement
 - ↓
 - 1 = total disagreement

1997 Survey

sent to

127 CEM funds with
1993 – 1996 data set

2005 Survey

sent to

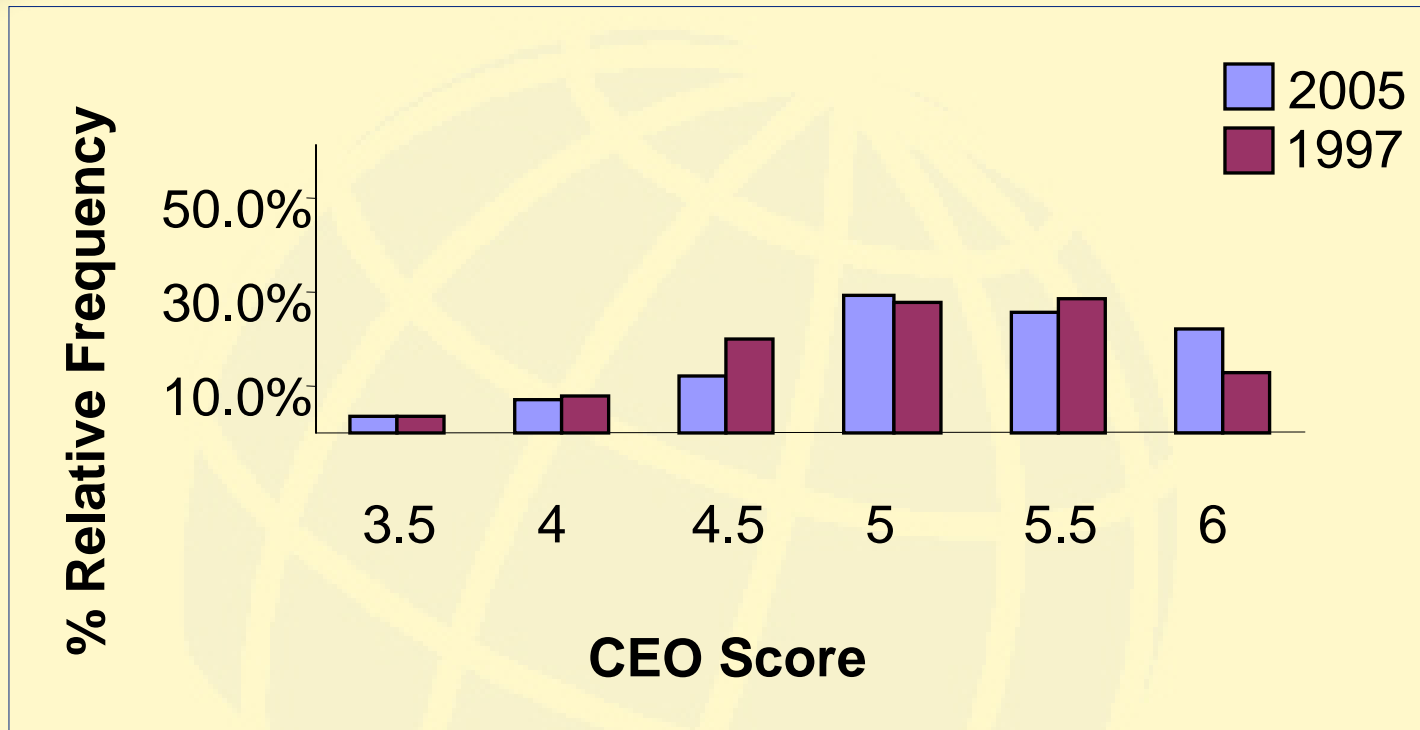
258 CEM funds with
2004 data set

The Data Sets (cont'd)

Comparative Statistics		
	1997	2005
Completed CEO Surveys	80	78 / 58 *
Average/Median Fund Size	\$8.0B / \$1.9B	\$16.4B / \$4.4B
Sponsor Distribution:		
Corporate	63%	34%
Public	24%	41%
Other	13%	25%
Regional Distribution :		
US	54%	45%
CDN	46%	40%
EURO	0%	12%
AUS/NZ	0%	3%

* Usable at this point

Relative Frequency of CEO Scores 1997 vs. 2005



1997 CEO Scores

Mean = 4.78

SD = 0.62

2005 CEO Scores

Mean = 4.93

SD = 0.67

Some Preliminary Findings

Six Highest-Scoring Statements

1997	2005
20	20
17	31
1	22
31	1
34	44
35	14

Note: Statements 20, 31, 1 were top-scored in both surveys

Six Lowest-Scoring Statements

1997	2005
42	42
16	16
8	8
9	30
30	9
43	43

Note: These six statements were bottom-scored in both surveys.

Three Consistently Highest-Scoring Statements

- Governance
 - *My governing fiduciaries do a good job of representing the interests of plan stakeholders.*
- Management
 - *I can describe our mission (why we exist).*
- Operations
 - *I ensure the setting of clear, appropriate, understandable, and well-communicated performance standards for our external investment managers.*

Six Consistently Lowest-Scoring Statements

- Governance
 - *Our fund has an effective process for selecting, developing, and terminating its governing fiduciaries.*
 - *My governing fiduciaries examine and improve their own effectiveness on a regular basis.*
 - *My governing fiduciaries do not spend time assessing individual portfolio manager effectiveness or individual investments.*

Six Consistently Lowest-Scoring Statements (cont'd)

- Operations
 - *I have the authority to retain and terminate investment managers.*
 - *Performance-based compensation is an important component of our organization design.*
 - *Compensation levels in our organization are competitive.*

Five Statements With Largest 1997-2005 Score Changes (>0.5)

- Governance
 - *My governing fiduciaries examine and improve their own effectiveness on a regular basis. (+)*
- Operations
 - *Employee turnover within the pension fund organization is low. (+)*

Five Statements With Largest 1997-2005 Score Changes (>0.5)

- Management
 - *I have clearly-written documents describing our vision, mission, values, strategic position, operational plan and resource plan. (+)*
 - *I can describe our operational plan (what are we going to accomplish in terms of quality, quantity, timeliness, and resource requirements. (+)*
 - *My superior investment performance reduces the future contributions of the underwriters of the pension promise (usually shareholders and taxpayers. (-)*

Preliminary Conclusions from CEO Score Analysis

- Pension Fund governance is still a work in progress.
 - Specific challenges continue to be:
 - Board member selection processes
 - Board self-assessment processes
 - Board micro-management

Preliminary Conclusions from CEO Score Analysis (cont'd)

- The good news that governance and management practices are perceived to have improved materially in the last 8 years.
- Compensation in the pension fund sector continues to have significant room to become more competitive, and to become more performance-based.

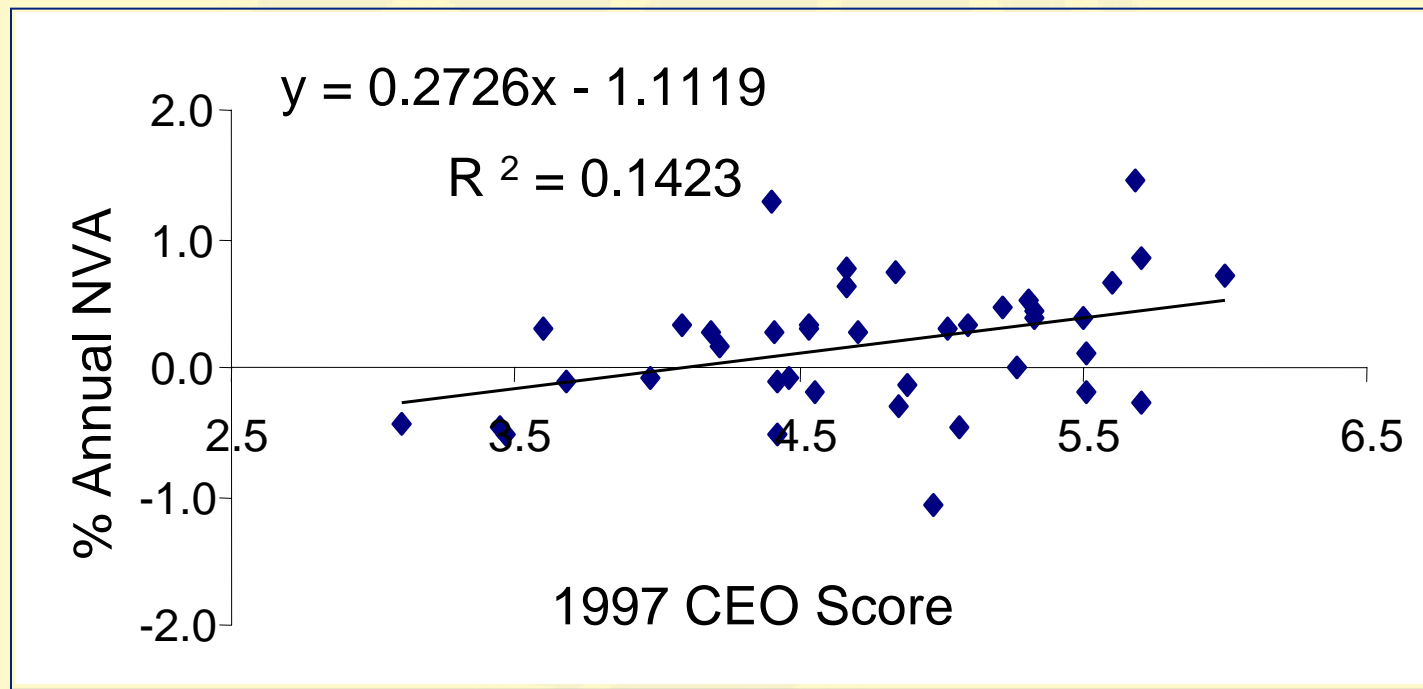
NVA vs. 1997 CEO Score and Size: All Surviving Participants

- CEO score co-efficient was positive in 11 of 12 years, with a mean of 0.3 (t=3.0).

Year	Co-Efficient		T-Value		No. of Plans
	CEO Score	Log 10 Size	CEO Score	Log 10 Size	
1993	0.6	0.0	1.4	-0.1	80
1994	0.3	0.1	1.0	0.2	80
1995	0.2	0.8	0.6	2.3	80
1996	0.5	0.5	2.1	2.2	80
1997	0.8	0.0	2.6	-0.2	69
1998	0.5	0.1	0.8	0.3	67
1999	0.4	1.9	0.6	2.8	63
2000	-0.6	-0.5	-0.9	-1.1	60
2001	0.1	-1.2	0.1	-2.8	57
2002	0.1	-1.0	0.3	-2.7	52
2003	0.7	-0.2	1.2	-0.3	46
2004	0.3	0.3	0.7	0.8	40

Annual NVA vs. 1997 CEO Score, 1993-2004

- For the 40 participants with 12 years of continuous performance data, the CEO score co-efficient was also 0.3 (t=2.5)



Relationship of CEO Score to Past and Future Performance

- CEO score co-efficient was 0.3 (t=1.7) both before and after the 1997 CEO Survey was conducted.

Period	CEO Co-efficient	Constant	T-value CEO	Constant	No. of Plans
1993-2004	0.3	-1.1	2.5	-2.1	40
1993-1996	0.3	-1.6	1.7	-1.9	40
1997-2004	0.3	-0.9	1.7	-1.2	40

NVA vs. 2005 CEO Score and Size: All Surviving Participants

- CEO score co-efficient has been positive 5 out of 5 years, thus far, with the new CEO scores.

Year	Co-Efficient		T-Value		No. of Plans
	CEO Score	Log 10 Size	CEO Score	Log 10 Size	
2000	1.5	-2.6	1.6	-3.0	48
2001	0.7	-1.4	1.4	-3.1	50
2002	0.2	-0.3	0.4	-0.6	52
2003	0.5	0.2	1.1	0.5	55
2004	0.1	0.4	0.7	2.1	58

Preliminary Conclusions from NVA vs. CEO Scores Analysis

- Persistent, positive association between pension fund performance and 1997 CEO scores, both over 1993-1996 period, and over 1997-2004 period.
- 'Strong-weak' CEO score spread of about 1% / year re-confirmed (i.e. $0.3 \times 3 = 0.9\%$)
- Persistent, positive association between pension fund performance and 2005 CEO scores over 2000-2004 period.