PENSIONS, MANAGEMENT AND LEADERSHIP:

14

LESSONS FROM INVENSYS PENSION SCHEME'S FORMER CEO/CIO

14 Things I Learnt About Pensions, Management and Leadership as CEO and CIO of the Invensys Pension Scheme

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Introduction

As part of a ten-year transformational plan initiated in 2000, the Board of the Invensys Pension Scheme (IPS) changed the business management model of the scheme in 2008.

The purpose of that change was to increase and improve the Board's control of the scheme's high impact / high value-add activities.

I joined IPS at the end of 2008, and accepted the mandate as their CEO and CIO (CIO for 2 years only).

During that journey, we experienced a number of events, some professional and technical, some more subjective and others personal. I have endeavoured through this paper to translate these events into 14 lessons I have learnt and which I think apt to share with you.

The lessons are split into four categories:

Management and Strategy

1. **A UK DB pension scheme is a proper and independent business: it should be managed as such**
2. **Doing it in-house and cheaper doesn't always create value**
3. **"A goal without a plan is just a wish" – *Antoine de Saint Exupery***
4. **Balance vision, delegation and "execution", with a bias on execution and delegation**

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7. **Manage the scheme and your advisers holistically**
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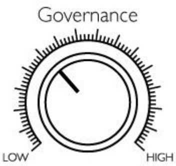
More on the Invensys Pension Scheme

Management and Strategy

1. A UK DB pension scheme is a proper and independent business: it should be managed as such

I used to hear, and sadly still hear, that UK corporate DB pension schemes are considered as a weight, a cost centre, a liability. That the only way to “fix” them is by paying contributions and minimising costs rather than managing them as a proper business.



Pension schemes are long term investors and therefore have the time to be successful businesses.

A first step to implement a successful business management model is to focus on the pillars of the scheme: its governance.

But how do you ensure that you are focussing on the right aspects of the scheme’s governance?

One suggestion is to answer the following question: “what is there to stay?”

a. The decision-makers: hire **experienced** and **expert** scheme-, industry- and role-specific Trustee directors. That is crucial because they are the ultimate decision-maker, unlike in the corporate world (more on that later);

b. Risk management: build your governance and executive structure adopting a holistic and integrated pension fund risk approach; be open and seek input from all stakeholders, your team members, your advisers and your portfolio managers when doing so;

c. High impact/high vale add activities: hire in-house expertise/experience in the high impact/high value add activities of the scheme;

d. Complementary advice: complement your in-house skills by investing in strategic, tactical and execution advice of quality, especially when you have a small executive team;

e. Build a data-driven and data-centric organisation;

f. Proximity: if possible, set up your executive office close to the scheme’s key stakeholders and advisers.

2. Doing it in-house and cheaper doesn’t always create value

Because you can do it more cheaply in-house doesn’t mean that you are better at it, and certainly doesn’t mean you are able to create more value.

A scheme’s absolute cost is still too often viewed as a key metric when considering pension strategy.

You might find the following factors used for IPS’s decision-making process useful:

Start with the end in mind

a. design your activity around the investment outcomes your stakeholders require;
   - don’t try to be all things to all people:
   - focus on areas of differentiation and opportunity;
   - build around structural competitive advantage;
   - focus on, and invest heavily in, what is there to stay; for example:

- risk, data, cash, liquidity, financial and reporting management,
- treasury, and
- capital allocation

  are activities core to the organisation, required as long as it a going concern.

b. weigh the impact of growing your in-house capabilities on the executive team's job:

   - I have seen, and still see, too many CEOs / CIOs who spend more time on HR and organisational matters than strategic asset allocation for example;
   - too great a size and complexity of the organisation can kill competitive advantages and flexibility:
     - short-termism creeps in despite being a (very) long term investor by nature;
     - herd mentality: for example, the asset manager performance review process is simplified to the extreme by blindly following simple benchmarks because the decision-making process within the organisation is too complex.

A great example for this lesson is the decision made in 2011 by IPS to outsource its in-house pension administration business (20 employees, c. 90.000 members of which 55.000 pensioners). Despite the absolute cost of outsourcing being higher than the basic operating cost of the business, that strategic move created more value to the Scheme's stakeholders than keeping the activity in-house.

3. **"A goal without a plan is just a wish" –** Antoine de Saint Exupery

A team is always at its best when working off a plan.

We all have our own techniques when it comes to structuring and drafting a business plan. The ones below are therefore just a few example of what worked at IPS.

a. Apply the "80% Ask – 20% Tell" rule: build a comprehensive understanding of what the organisation believes needs to be done in the next 12 and 36 months and, more importantly, build execution buy-in from your team by:

Team buy-in

   - seeking input/views from your staff, your key advisers/other service providers, Board members and other key stakeholders on:
     - the state of the organisation today;
     - what they think should be done in the medium and long term (12 and 36 months);
     - how best to execute these actions to maximise timely achievement.
   - adding your understanding/views of the organisation and what you believe needs to be done.
   - drafting your plan taking into account both sets of views and inputs, by order of priority.
   - presenting the plan to the team: having participated in its design, their buy-in should be greater.

b. Continuously seek to build sustainable organisational capability when designing/executing your business plan i.e. ensure that the organisation, through its governance, talents, processes and systems is not over-reliant on its leaders / managers.

Crisis management

c. Finally, prepare for the worst and hope for the best: carefully plan reader-friendly, simple, executable and many times tested disaster recovery plans (the default of an investment bank counterpart for example). Many forget that a crisis is a very stressful and emotional situation to be in and very few can manage one confidently without adequate training and relentless practice.

4. Balance vision, delegation and "execution", with a bias on execution and delegation

I am not sure many realise how the selection of a UK pension scheme CEO is a tricky exercise for a Board. The job requires the usual balance of vision, delegation and execution skills, a theme that has been much debated by leadership experts and academia.

In the UK pension fund world however, I feel the balance could lean more towards execution and delegation skills:

a. "Execution is everything" – Jeff Bezos.

   Unlike corporate CEOs, pension fund CEOs usually have small in-house teams and more limited resources. Therefore, the CEO must be fluent in his/her ability to "do" and execute.

b. The importance of that skill is reinforced by the governance applicable at many UK pension schemes, which is still too often inappropriate given the nature and size of the organisation and the volatile environments it has to perform in. Too many projects lose momentum, die before their goal is achieved or "trod along" for years without creating value because of a lack of execution ability combined with inadequate governance.

c. Delegation and external adviser management: again, given small in-house resources, a CEO might have to rely on and trust his advisers to help him create long term value for the fund.

Finally, another required skill for a pension CEO worth mentioning is the investments, risk management and corporate sponsor knowledge and experience. He/she need not be a superstar in these fields: assets, liabilities and corporate sponsor strategy being however high impact / high value-add activities of the scheme, a good understanding of these matters are key for a successful pension scheme CEO.

Infrastructure and Operations

5. Build a data-driven and data-centric organisation

The inherent nature and business of a pension fund revolves around data: member data (liabilities), investment data (assets) and everything in the middle (risk management).

Combine that with volatile and fast-changing business environments (regulatory, accounting, capital markets, investments…), and the only way a Trustee is going to be able to understand and quantify the risks it is running and make informed decisions is by building a robust predictive data and information management framework and platform.

One of IPS's key tools for success was investing heavily in precise data management systems and processes from 2009. It was also the vector that led to an integrated work flow and risk management approach between the corporate sponsor and Trustee.

Initially viewed as too expensive because its long term value was not fully tangible for the Trustee, we approached Invensys and worked together to co-finance the data management framework, identifying pockets of value that would be created for both sides.

The **benefits** of that framework and platform are:

a. Precise identification, quantification and understanding of all investments, capital markets, liquidity and actuarial risks run by the scheme;

b. Reduced assets and liabilities uncertainty;

c. Increased control over the scheme's proprietary data and reduced reliance on external service providers (and their cost);

d. Near instantaneous access to the scheme's data and its modelling ability;

e. Ability for executives and decision-makers to make more informed and timely decisions;

f. Timely and informed communication and reporting;

g. Builds trust and comfort at Trustee and corporate sponsor level;

h. Improved the relationship between the Trustee and corporate sponsor;

i. The capital markets became more comfortable with the scheme thanks to an informed education effort led by Invensys, which changed the negative perception of the scheme, mainly due to the uncertainty around assets, liabilities and risks.

6. Ordinary things consistently done create extraordinary results

Shooting for the moon is great but takes time to achieve.

In the meantime, an enterprise culture where each member of the team continuously focusses on making small improvements all along the scheme's "value chain" adds up, at times, to surprisingly significant value over a year.

At IPS, we realised that an effective way of achieving these improvements was through the setup of small and very expert groups of 4/5 persons. The benefits were:

a. Improved working relationships with our advisers and corporate sponsor: each working group included at least 2 advisers and representatives of the sponsor where applicable;

b. Increased productivity and efficiency of the working groups, no loss of momentum thanks to

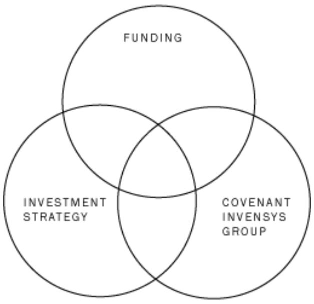
   - the high level of expertise and specialty of the participants;
   - the use of the advisers' and sponsors' significant resources.

c. Small but consistent financial gains, amounting to sizeable sums of money at the end of the year;

d. Consistent "lean and mean" spirit that created valuable team familiarity.

Stakeholder and Third-Party Service Provider Management

7. Manage the scheme and your advisers holistically



A UK pension scheme is the aggregation of different stakeholders, activities and businesses. Their interdependence is such that they should be addressed and managed in a holistic way, integrating the management of the scheme's key risks: funding, investment strategy and corporate sponsor.

And I suggest you do the same with your advisers: require that they be involved in all key aspects of the scheme.

One of the great successes at IPS was the way we managed the relationships with our advisers: on a holistic basis and involving them in every aspect of the scheme's business. Every meeting and call involved representatives of the scheme's legal, investment, actuarial and corporate sponsor advisers. This allowed them to understand the whole context of the scheme:

a. lawyers understood both sides of the balance sheet;

b. investment advisers were fluent in corporate sponsor covenant management;

c. the actuary was an expert in capital markets risk management.

Some of the benefits of that approach were:

a. greater quality, depth and speed of advice;

b. valuable team familiarity;

c. "can achieve attitude": the advisers felt involved in and being a part of the scheme's journey.

8. Portfolio managers should become your trusted advisers

Remember, they manage significant sums of money on your behalf. Should you therefore only call them from time to time?

Creating an on-going and trusted relationship with your asset managers proved to be extremely valuable to IPS's ALM activities, investments and risks management, trustee and executive education.

The continuous and trusted aspects of the relationship were achieved through:

a. Very regular communication: at least every other week, at times every other day with the key managers (the LDI manager in IPS's case). That frequency, depth and intensity of communication had the following effects:

   - They feel part of the scheme's journey, rather than just a cog;
   - It "keeps them on their toes": continuous dialogue (not nagging!) creates constructive pressure;
   - Tremendous education, training and coaching potential for the Trustee and the executive team: asset managers are often large, powerful, immensely well-resourced institutions attracting the best talents in the industry, and proficient in risk management systems, procedures and processes. Leverage their IP: they are a fountain of knowledge just asking to be used.

- More open fee negotiations: IPS renegotiated its fee agreements to be more in line with its objectives, constraints and profile.

b. Deeper involvement in the scheme's investment and risk management strategy.
Involving and including your asset managers in the scheme's holistic investments and risk management allows them to have a global picture of the scheme, its objectives, its constraints and its journey. It allows them to understand where they fit in the whole value proposition, what portion of the risk budget they use, how they can contribute to the scheme as a whole but also how they can impact it.

9. Non-executive trustee directors bear the weight of great responsibility

UK pension scheme directors are (mostly) non-executive directors. They hold however a great level of responsibility because they are the ultimate decision-makers in the organisation and still call many of its shots, especially for schemes with small or no in-house teams.

I feel therefore that their role and functionality, unlike non-executive directors in the corporate world, should be revised with special emphasis on:

a. Time commitment: it could be greater than in the corporate world. Meeting four times a year might not meet the scheme's requirements.

b. Experience/expertise: should be scheme-, industry- and function-specific.

   However, this is difficult to implement today given current regulations around stakeholder representation at Board level.

c. Their selection process: stakeholders should ensure it is more rigorous than that of a corporate executive;

d. Hiring an executive Chairman with extensive business experience.

   Until b. changes, the Board could appoint a robust, knowledgeable and business-experienced Chairman to manage the board, the various committees and oversee the executive team or advisers.

At IPS, the Board fully committed to the change of business management model: for example,

a. The chairman became more involved i.e. became executive chair;

b. The trustees' meeting schedules adapted to the scheme's needs and revised governance; for example, the Investment Committee met 11 times (physically or by call) the first year of the change and the Chair of the Audit/Governance Committee is a former corporate Finance Director;

c. (Information) Technology was enhanced and tailored to ease the trustees' increased governance activity.

10. Understanding the balance between executive and non-executive performance and developing an appropriate training programme

A CEO / CIO, as an executive, is well-versed in the tools, products and lingo related to his job/functions.

It is his duty, however, not to forget that Trustee directors remain non-executive directors, i.e. it is not their day-to-day job, despite their ever-growing commitment to the scheme.

Pension executive peers have mentioned frustration creeping in the relationship between them/their executive team and Trustee directors.

We often forget that trustees, who meet around 4/5 times a year, are decision-makers, not executives or “do-ers”: they will require therefore to be reminded or even trained again and again on topics that appear trivial for the executives.

It is therefore a senior executive’s responsibility to build and maintain a trusted relationship with the Board through on-going communication, education and training of its members.

How does one develop a continuous and relevant Trustee/executive education programme? Below are a few suggestions, based on the immense service industry covering the pension scheme industry:

a. Identify and select the areas / topics the trustees need to be educated on: capital markets, investments management, actuarial sciences, accounting, (corporate) finance, risk management, (thought) leadership, regulations, legal…

b. Identify the top 5 service providers in each category and the top 5 industry representative bodies and regulators (NAPF, IMA, TPR…);

c. Design a systematic education and training programme whereby

   - a request for information is sent every quarter to the institutions identified in b. on the education/training sessions they will be organising over the next 12 months;
   - the training/education schedule is updated quarterly and discussed with the trustees during each Board meeting;
   - A record of education and training sessions is maintained and monitored by the Chairman or a sub-committee.

Leadership and Personal Lessons

When I joined the IPS as CEO and CIO in October 2008, I realised quickly I had a few challenges to face when it came to leading a big enterprise where, by law, the ultimate decision-making authority still rested with non-executive directors:

a. Relative youth: I’d just turned 33 years old when I joined;

b. Professional background: I had spent all of my career in the investment banking industry, not really flavour of the month at that time (Lehman Brothers had just gone bust);

c. Little pension managerial experience: the Chairman of Trustee had decided that capital markets and risk management expertise and experience were a priority for the scheme along with multidisciplinary advisory team management experience and, with her help (she specialises in coaching and mentoring senior executives and non-executives), I would learn how to run such a large enterprise on the job.

The following lessons are very personal and might help those who can’t put words on certain issues.

11. Don’t stay alone at the top

Being at the top can be very lonely and disorientating, especially when i. it is the first time, ii. you are setting up an executive office from scratch and iii. you come from an environment where team-work, collaboration and intellectual emulation are part of the DNA of the organisation.

Below are a few actions that helped overcome the situation:

Strategically, ensure you have a robust sounding board:

a. Build a trusted relationship with the Chairman of Trustee / Chair of the Investment Committee;
b. If you don't have one, find a mentor. If possible, someone who has been in a leadership role;
c. Get a coach! Professional athletes are coached every day, especially when they reach the top.

Professionally and technically, be humble:

a. Seek regular feedback from your senior advisers and senior portfolio managers (more below).

12. Seek feedback

Favour reverse performance reviews: being at the top doesn't exempt you from feedback.

Obviously, seek feedback from your colleagues, from trustees and from the Chairman. And do it frequently or after the completion of each project, milestone or key meeting (a Board meeting for example): the usual one year is too long a time to wait for feedback.

Most importantly, remain humble and open, and seek feedback from your senior advisers and portfolio managers! **Learn to trust them and get more out of them.** Generally, they are extremely competent, professional and well versed in the delivery of feedback as it is often part of the culture of the institutions they work for. You will gain and learn a lot from them.

IPS's new business management model was such that I used to spend as much time with our advisers and portfolio managers as with other employees of the scheme. They were an integral part of IPS's value proposition. Therefore, we continuously sought to understand whether our mutual interactions and working relationships were appropriate and how they could be improved through periodic feedback sessions.

13. Raise your hand when the going gets tough

Leadership is premised on the exercise of good judgement. Good judgement is best achieved when balance between professional, personal and emotional circumstances is achieved.

We are not machines and it happens that the balance breaks. It is our duty however to remain professional and serve the interests of the scheme. When the balance breaks and you feel that your good judgement capability might be impaired, raise your hand, inform the Chairman, the Board and your mentor of what you are going through. Forewarning allows for planning: the Chairman/Board will ensure you and the team are backed up.

Hence the importance of a trusted relationship with the Chairman of the Board.

14. Focus on the job, not on building your profile

I feel that UK pension scheme executives still spend too much time away from the organisation's core business activities.

Network building and knowledge sharing are key aspects of a successful executive career. However, a careful balance between attending external events and benefiting from the industry's huge education and training resources needs to be applied:

a. The UK pension fund industry is sufficiently small that having direct access to a peer is easy: a one-on-one session with a pension executive peer is more efficient and productive than spending 6 hours at a conference discussing generic issues;

b. There are plenty of excellent pension fund networks and circles (for pension professionals only), which executives can learn from.

c. Finally, most schemes have relationships with external asset managers and advisers. These are often vast and very professional organisations, with immense resources. Education and training is often at the core of their value proposition. And they are all very keen in you spending as much time with them as possible. Their sessions will be much more effective than being in a room with hundreds of other participants.

More on the Invensys Pension Scheme

Background on the change of business model

As part of a ten-year transformational plan initiated in 2000, the Board of the Invensys Pension Scheme (IPS) changed the business management model of the scheme in 2008.

The purpose of that change was to increase and improve the Board's control of the scheme's high impact / high value-add activities. IPS's key activities were categorised as:

1. Assets management
2. Liabilities management
3. Pension strategy
4. Corporate sponsor strategy
5. Pension Administration

Until then, the scheme had a management model that mainly relied on in-house expertise in Pension Administration (a 20-strong team). The expertise in the other key activities was covered through external service providers.

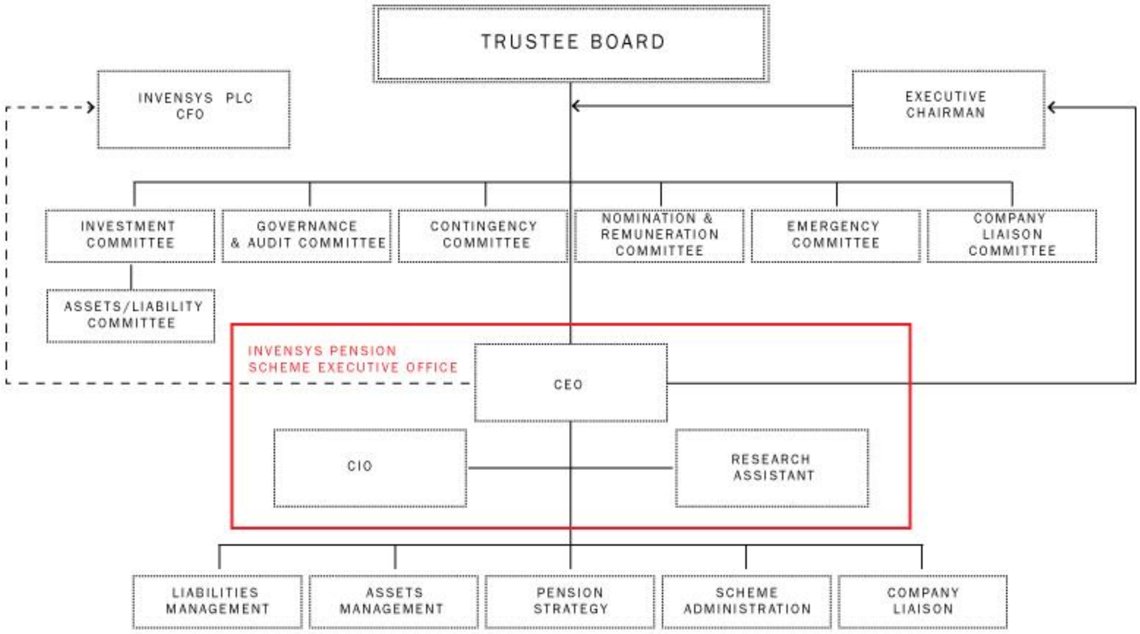
The decision in 2008 was made to hire a professional with investment banking, (corporate) finance and capital markets background to focus on the other four activities, the high impact / high value add ones.

And the initial mandate was to:

1. Set up an executive office, mirroring a corporate management model, to run what effectively is a large enterprise through a small executive team (£4bn of assets, c. 90,000 members);
2. Create an informed intermediary between the scheme and its stakeholders, regulators, service providers and the markets;
3. Manage the scheme in a truly and effective holistic way: the scheme wasn't just supposed to become a performing business; it was supposed to embody a joint strategy between all stakeholders, integrating funding, investment strategy and corporate sponsor covenant risks

Integrating pension scheme risks

The Invensys Pension Scheme Organisational Structure



Meet the Author

Robin Claessens

Managing Director, Investment Consulting

- Former CEO and CIO of Invensys Pension Scheme (IPS), responsible for Liability Management, Asset Management, Corporate Strategy, Administration and Corporate Sponsor Liason Strategy

- Oversaw IPS's Trustee Board, Governance & Audit Committee and chaired its Asset & Liability Committee

- Member of the Steering Committee of the Milken Institute Young Leaders' Circle and Insead UK's Leadership Group

Contact:

+44 (0) 20 7250 3331

robin.claessens@redington.co.uk

If you would like more details on the topic discussed, please contact your Redington representative, the author or email enquiries@redington.co.uk

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