

Thinking Ahead breakfast seminar

17 September 2019



Global innovation partner

Influencing change

43

Institutional investment members comprising **asset owners** and **service providers** with combined responsibility for over **US\$12 trillion.**



The Institute is a global not-for-profit innovation and research member group whose **purpose is to lead change** in the investment industry for the benefit of the end saver.



Member benefits:

- One-to-ones
- Toolkits
- Workshops
- Networking
- Thought leadership
- Members-only website
- Highly engaging events
- Research working groups

What we will cover

Theory



Tim Hodgson

People



Roger Urwin

Culture



Brandi Wust

Industry



Bob Collie

Sustainability



Jennifer Kruse

Stronger investment theory and practice

Tim Hodgson

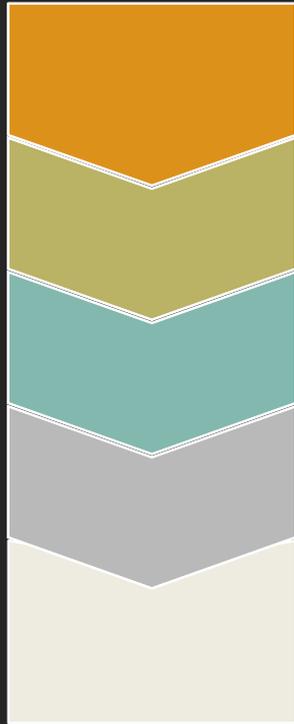


**Clouds are not spheres, mountains are not cones,
coastlines are not circles and bark is not smooth, nor
does lightning travel in a straight line.**

Benoît Mandelbrot "The Fractal Geometry of Nature"



A hierarchy of uncertainty



Irreducible uncertainty



Partially reducible uncertainty

Fully reducible uncertainty

Risk without uncertainty



Complete certainty



Andrew Lo and Mark Mueller, "WARNING! Physics Envy May Be Hazardous To Your Wealth"

VUCA

Volatile

Uncertain

Complex

Ambiguous

Religion

Philosophy

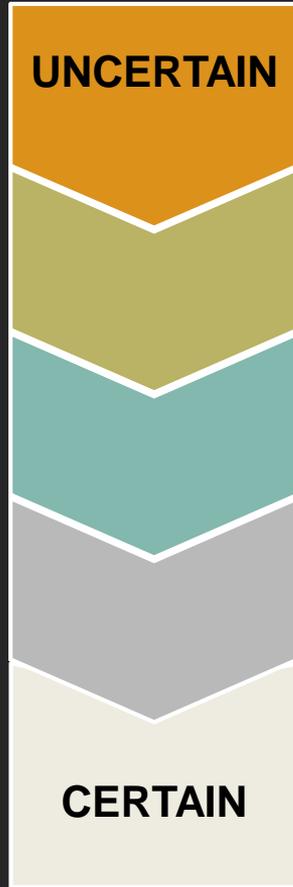
History

Biology

Chemistry

Physics

Mathematics



“...the failure of quantitative models in economics is almost always the result of a mismatch between the type of uncertainty in effect and the methods used to manage it.”

Andrew Lo and Mark Mueller
“WARNING! Physics Envy May Be Hazardous To Your Wealth”

For example...

...how we use models

Don't marry a model



Good is good...

**...but optimal is not
necessarily better**



For example...

...things change



**Feedback
loops can
create stability**



**Feedback
loops can
create chaos**

STRONGER theory

STRONGER practice

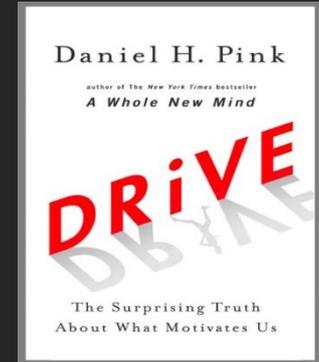
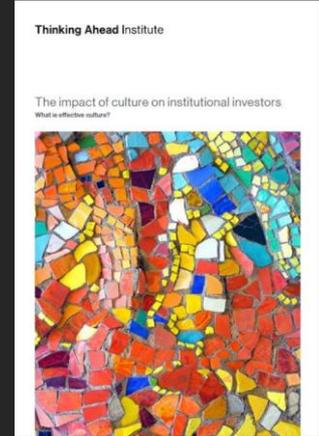
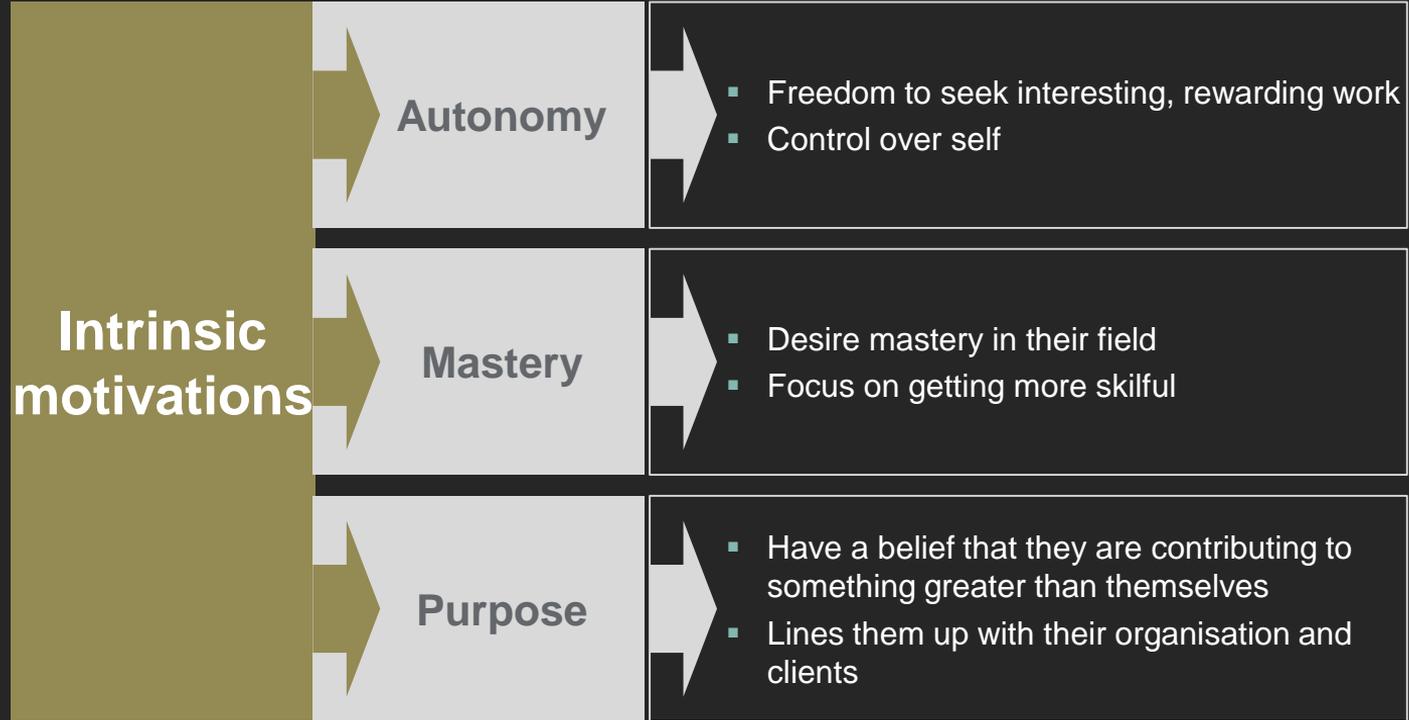


The renaissance investment professional

Roger Urwin



The investment professional of tomorrow is purpose driven



The investment professional of tomorrow is well-motivated by their firm



Phi
Purpose + Habits + Incentives

Source: CFA and State Street

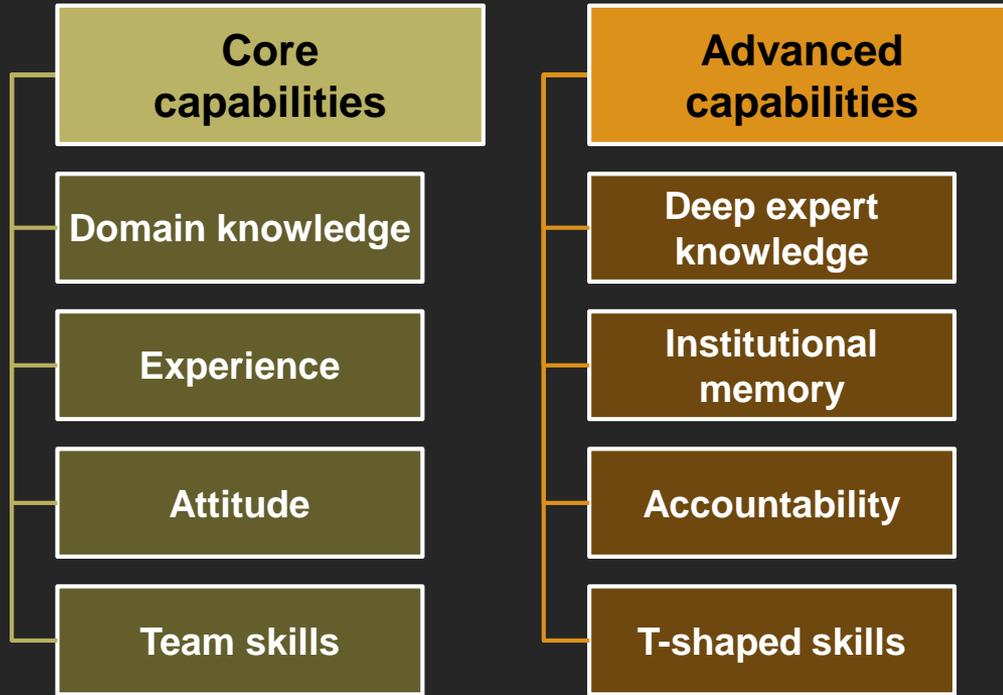
The investment professional of tomorrow is skilled in old and new ways

In a more complex world, T-shaped skills are critical

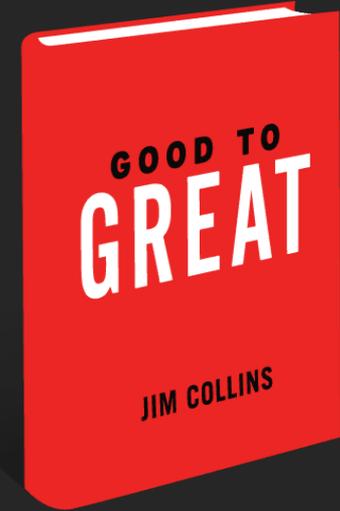
- Core investment skills remain critical but more skills are needed going forward
- Digital and analytics opportunities
- T-shaped skills
 - wider knowledge across disciplines
 - deeper relationships and connections
 - smarter on delegations
 - 'savvy' and empathetic attributes

The investment professional of tomorrow is a very strong team player

Team players know the role they need to play



Source: Four Plus Four Model | Clark and Urwin



Getting the right people on the 'bus'
Jim Collins | Good to Great
*Best-practice investment committees:
taking them from 'good to great' | TAI*

**...and remember the
T-shape**



Culture in asset management

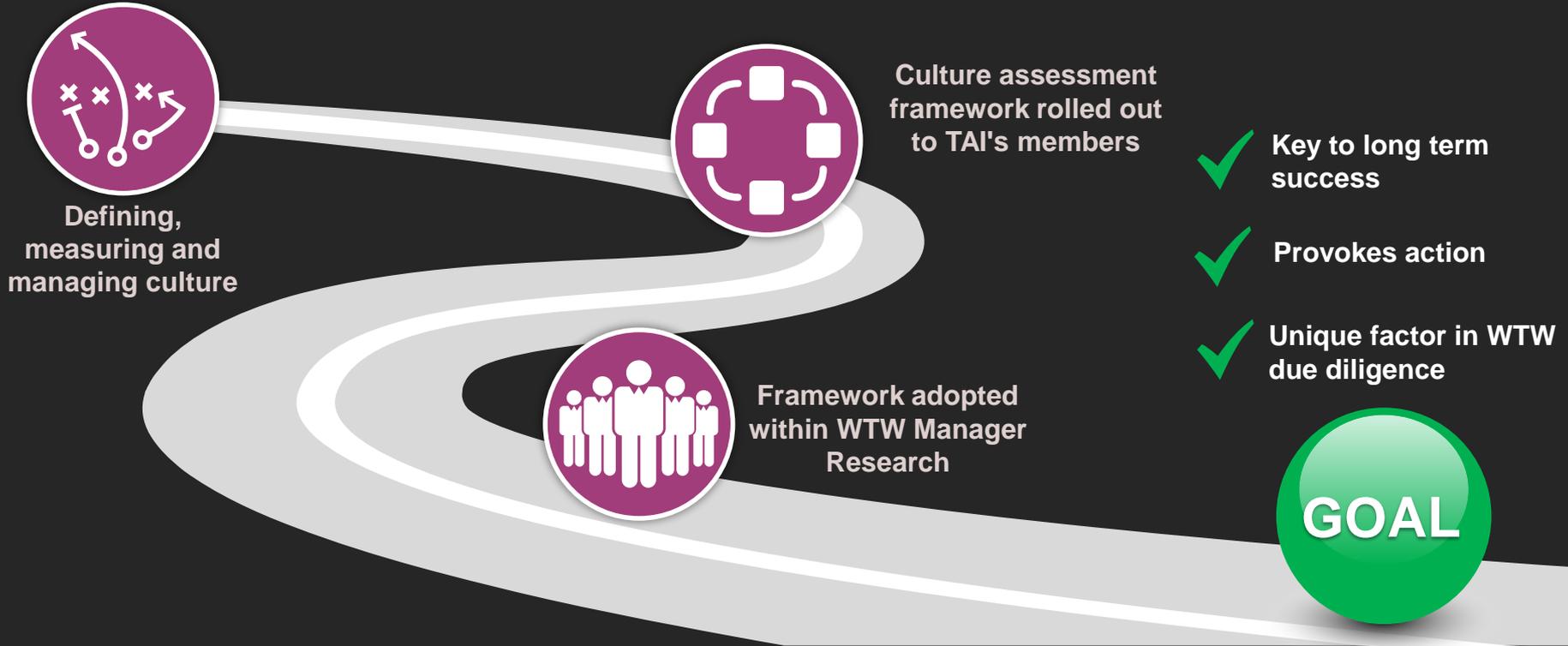
Brandi Wust



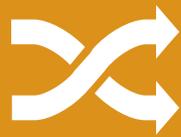
Culture stories



Our culture assessment journey



What is culture?



Collective influence from shared values and beliefs on the way the organisation thinks and behaves



The way we do things around here



WTW culture framework



Culture assessment report

Sample Assessment Output: EVP Score

EVP score – XYZ Manager		
1. Clarity of responsibilities, accountability for outcomes	Strong	Roles are clear, performance targets are transparent and the structure reinforces client-centric outcomes.
2. Performance development opportunities	Moderate	Flat organisational structure where everyone benefits from superior performance if the organisation through equity (ownership), individuals support one another to achieve superior overall results. We were told that analysts are expected to be as good at teaching as they are as a client. Some analysts have the potential to become portfolio managers. Although product proliferation has not been an issue, growth of the fund could potentially result in a risk in the future.
3. Great colleagues, bosses and leaders	Strong	There has been no turnover from the investment team since the firm was founded in 2001. This reflects the thought put into how the founding partners would structure and manage the business.
4. Recognition in informal and formal ways	Strong	We were given examples of how the team recognises great work or the 'heavy lifting' done by a colleague, including an 'alpha' hat or a dumbbell. They have semi-annual parties to celebrate successes. The ultimate award each year is equity which drives the average distribution each individual receives.
5. Meaningful work with purpose and impact	Moderate/Strong	Each analyst is expected to be an expert in a higher specialist area but is also have an ability to perceive and understand the broader market and economic context. Performance objectives are unambiguous and recognition of the contribution of individuals to client outcomes is deliberately made public.
6. Disciplined and effective performance management	Moderate	The approach appears to be highly disciplined although the results for some products have not been as constructive as one might expect (this challenged on the somewhat incremental results over rolling 1, 3 and 7 years there appeared to be a difference of opinion as to how much attention should be placed on historic performance as opposed to consistency with the principles of the investment philosophy. We suspect there is more common ground than there is a difference of views.
7. Appropriateness for performance, performance philosophy, equitable design	Strong	The culture of XYZ is positive with a clear focus on rewarding favorable client outcomes. It is well known that the culture of XYZ is positive with a clear focus on rewarding favorable client outcomes. It is well known that the culture of XYZ is positive with a clear focus on rewarding favorable client outcomes. It is well known that the culture of XYZ is positive with a clear focus on rewarding favorable client outcomes.

AS AT

AS AT 30 SEP 2017

Sample Assessment Output: Positive Culture

XYZ Manager		
Summary	EVP – Intrinsic Incentives	CVP – General Excellence
<p>Translating the company's employee and value proposition (from Roper (Unit's) framework) into measurable categories for assessment framework is particularly an issue as large asset managers may have varying sub-cultures across the firm.</p> <p>These are just some of the main points to consider when assessing a manager's culture, there may be other factors to consider – as are below (with more ideas may come out of this). This framework is a starting point to manage, culture and be based on future potential of the product.</p>	<ul style="list-style-type: none"> Clarity of responsibilities/ accountability: Transparent performance targets, clear roles. Teamwork: Appears to be generally collaborative, no competition for having more ideas at the portfolio, better fit and been more. Development opportunities: Limited opportunity to be a PM (limited in number). Recognition (formal & informal): Stock portfolio awards, 'alpha' hat for best performer, semi-annual parties with a strong emphasis on team equity. Meaningful work with purpose and impact: Clear focus of firm, low turnover suggests employees enjoy the work. 	<ul style="list-style-type: none"> Client service/retention: Relatively recent (3 years) spend more time on fund. Product management: As and mentioned in briefing. Integrity & ethical conduct: Some misalignment on self. Thought leadership/innovation: seem willing to be at the industry change (the example of ESG).
Leadership	EVP – Extrinsic Incentives	CVP – Performance Expectations
<ul style="list-style-type: none"> Empowerment/autonomy: With a credo of delivering equity for performance and no employee turnover on the investment side, extremely strong sense of individual employees. Performance incentives/values: Clear and objective values and focus on performance. Fairness/equity/engagement: Very objective view of leading the organisation and encouragement of idea generation. Adaptability to change: Seem to view prior experience and bring them as the solution, without thinking about existing process. 	<ul style="list-style-type: none"> Compensation design & communication: Extremely transparent comp formula open to firm. Appropriateness pay for performance: Equity distribution for performance objectives. Presence/absence path: Limited opportunity to be a PM (limited in number). Performance management: Different definitions of success by law, however, do think of performance for client portfolio but don't seem as thoughtful in a more period where they are underperforming. 	<ul style="list-style-type: none"> Track record: Recent underperformance though believe in their process that has been all important, don't believe there is a fix. Capability and IP: Robust hiring process, but does not seem scalable (one year trial period, potential to have gaps for a long period of time as they wait for the perfect fit). Talent recruitment process: Extremely robust, about time concerning with profiling, one year trial period. Alignment (reward, ownership structure, compensation): Equity, all owners. Capacity management: Very conscious would turn away capital if it is not in clients' best interest.
	<p>Key: ■ Positive ■ Neutral ■ Negative</p>	

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Sample Assessment Output: CVP Score

CVP score – XYZ Manager		
1. Track record of meeting clients performance expectations	Moderate	Recent performance has not been strong and this has dragged down longer term results as well. Our impression is that this is part of a normal market cyclical and that this will likely swing back in favor in due course.
2. Capability and IP supports achievement of future performance expectations	Moderate	The comprehensive hiring process may be difficult to scale and potentially inhibits their ability to find talent. There is a potential for selection bias, when challenged what they said if they had to fill a gap the answer was 'we just wait here'. If they were to suffer a prolonged period of underperformance, perhaps due to a lack of talent in a particular sector it is not obvious that they could hire someone quickly who would also be a good fit.
3. Strong professional purpose and ethical conduct in organization's values	Moderate	The partners came across as having a high moral and ethical standard in the way they manage the team. Focus on an achieving client goals and support the local community. It was therefore slightly disappointing that they are unwilling to address soft dollar commission until the practice ceases to be relevant for the industry.
4. Investments are aligned to good outcomes for clients	Strong	The compensation model appears to be well-constructed with client results at the core as the key motivating driver.
5. Alignment is practiced through co-investing	Strong	Employees are co-invested and equity ownership across 10 of the 25 employees helps to ensure good alignment.
6. The ownership structure aligns the organization to its clients	Strong	18 out of 25 employees are shareholders with thoughtful details such as ability to sell back, natural wind-down after certain age, etc. Currently about 22% of the equity is held by a private equity firm. We do not believe that this has led to any deviation from the strong client orientation.
7. Strong client equity	Moderate	XYZ believe that they can manage substantially more assets than they currently manage. They expressed a desire to limit capacity on the number of clients. We are not yet near that point but we have some reservations about how they they would fund to fund their business.
8. Strong client service, practiced and reassessed	Moderate	In 2013 XYZ expanded resources in client servicing to ensure that the three senior portfolio managers could spend more time on investments.
9. High trust levels in client relationships, clients value feedback	Strong	This appears to be a strength of the organization as evidenced by the continuing growth in assets against a backdrop of underperforming performance.
10. Capacity limits are practiced, old clients are particularly valued	Strong	The management team seem conscious of capacity and recognise that it is not in the best interests if a client's grow capital to the point where it would undermine the ability to manage portfolios well. They also said that they would turn capital away if they felt that it was not the right time, although it is difficult to know how likely this would be.
Overall CVP score	Strong	

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Culture discussion topics



Why do you do what you do?



What other value besides investment returns do you provide?



Who is the keeper of the culture?

What makes culture good?



Strong leadership that distributes power



Healthy balance between EVP and CVP



Incorporating diversity

In conclusion

“

Amazing experience – thank you for doing it! I had never been through this sort of assessment before and found it so interesting that after you left I gathered the whole team to discuss in detail how we can put more of it in action.

”

The asset manager of tomorrow

Bob Collie



2009



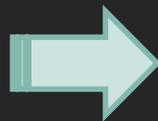
2009

2019

258

242

2009



2019

13%

return on S&P500

7%

growth in AUM

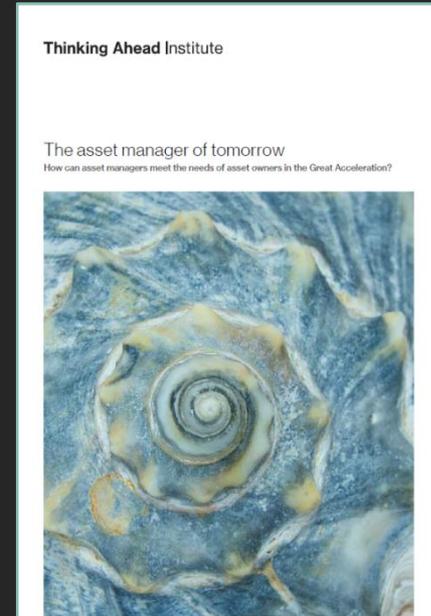
>30%

margin

2019 →
500

fees
risk
technology
DC
sustainability
data
passive
competition
private market
regulation
blockchain

An industry at a crossroads



The industry is being challenged on multiple fronts



Trust in the industry is low

Please tell me how you would rate the honesty and ethical standards of people in these different fields

GALLUP, Dec 3-12 2018

1. Nurses
2. Medical doctors
3. Pharmacists
4. High school teachers
5. Police officers
6. Accountants
7. Funeral directors
8. Clergy
9. Journalists
10. Building contractors
11. Bankers
12. Real estate agents
13. Labor union leaders
14. Lawyers
15. Business executives
16. Stockbrokers
17. Advertising practitioners
18. Telemarketers
19. Car salespeople
20. Members of congress



Trust in the industry is low

*“When trust is absent but products complex...
markets do not function well”*

*“...the demand for transparency in intermediation
is a sign that intermediation is working badly,
not a means of making it work well.”*

John Kay, Other People's Money

Keep your
head down.
Hope for
the best.

Recognize that
successful firms
don't dodge
industry realities.



Investment model

*more systematic,
more sustainable*

People model

*culture as an edge,
diversity as a value*



Operating model

*the power of people
plus technology*

Business model

*institutionalized
professionalism*



Purpose has hit the headlines

**Move Over, Shareholders:
Top CEOs Say Companies
Have Obligations to Society**

The Wall Street Journal Aug 19

**Shareholder Value Is
No Longer Everything,
Top CEOs Say**

New York Times
Aug 19

**Business must act
on a new corporate
purpose**

Financial Times
Aug 19

**Group of top CEOs says
maximizing shareholder
profits no longer can be the
primary goal of corporations**

The Washington Post Aug 19

**America's CEOs
just made a
significant, if mainly
symbolic, change**

CNN Business
Aug 19

**Top US CEOs say
shareholders' profits
no longer top priority**

FOXBusiness
Aug 19

A five-stakeholder model

“We commit to:

- *Delivering value to our **customers**.*
- *Investing in our **employees**.*
- *Dealing fairly and ethically with our **suppliers**.*
- *Supporting the **communities** in which we work.*
- *Generating long-term value for **shareholders**.*

Each of our stakeholders is essential.”

Business Roundtable, Statement on the Purpose of a Corporation

The asset manager of tomorrow needs a stronger purpose

“...dangerously possible that we will concentrate on succeeding with the business aspects of distribution and asset gathering, but unintentionally lose our grounding in the profession.”

Charles D. Ellis, Will Business Success Spoil the Investment Management Profession?

“There are no side-effects – just effects...”

‘Side effects’ are not a feature of reality but a sign that the boundaries of our mental models are too narrow, our time horizons too short.”

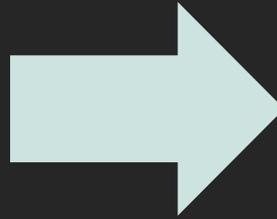
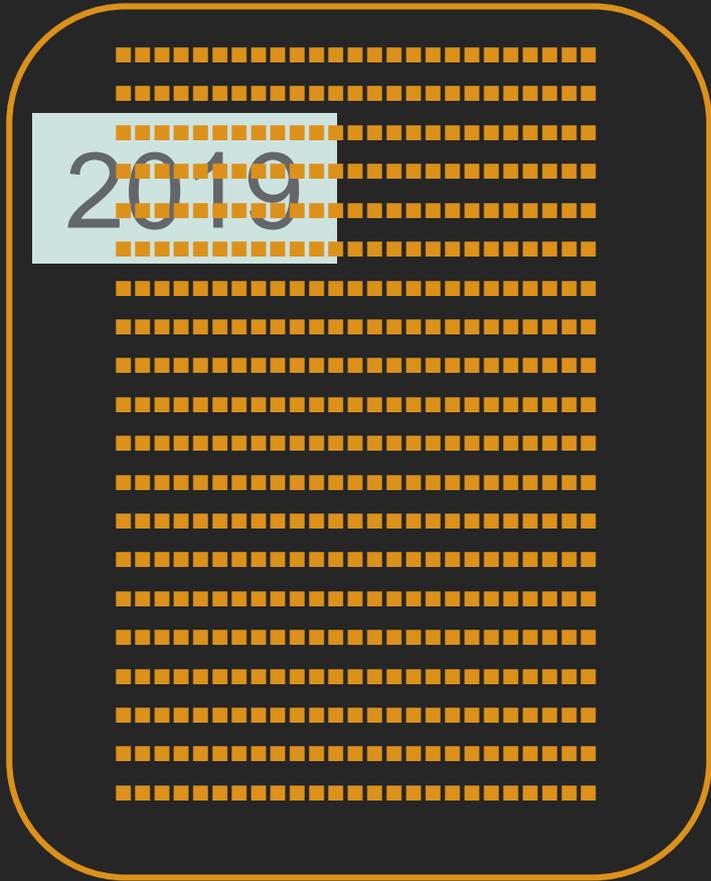
John Sterman, Learning from Evidence in a Complex World

Universal ownership

Undesirable, but possibly profitable, conduct may provide a gain to one company at the expense of others, thereby harming overall portfolio returns

Dimson, E. et al (2013)

Responsible Investment and the Norwegian Government Pension Fund Global



Key changes for the asset manager of tomorrow

Investment
strategy



Outcome focused,
more dynamic,
more sustainable

Organizational
effectiveness



Stronger purpose,
better governance,
culture by design

Societal
legitimacy

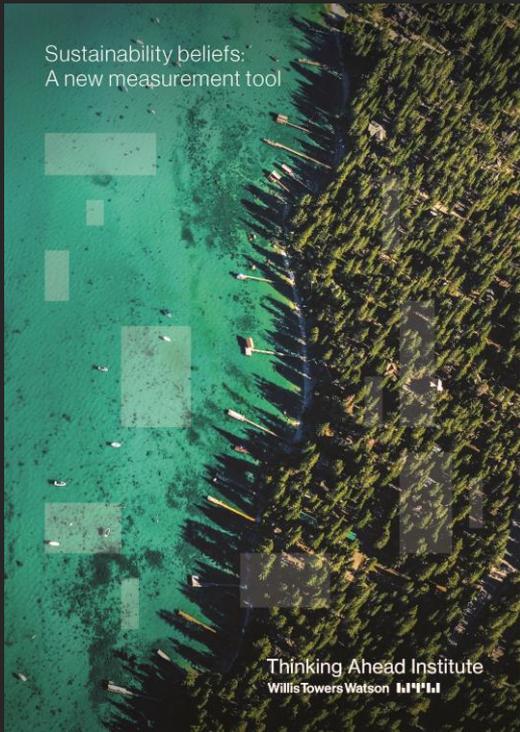


Rebuild trust and
the social license
to operate

Sustainability in investment

Jennifer Kruse





Sustainability beliefs:
A new measurement tool

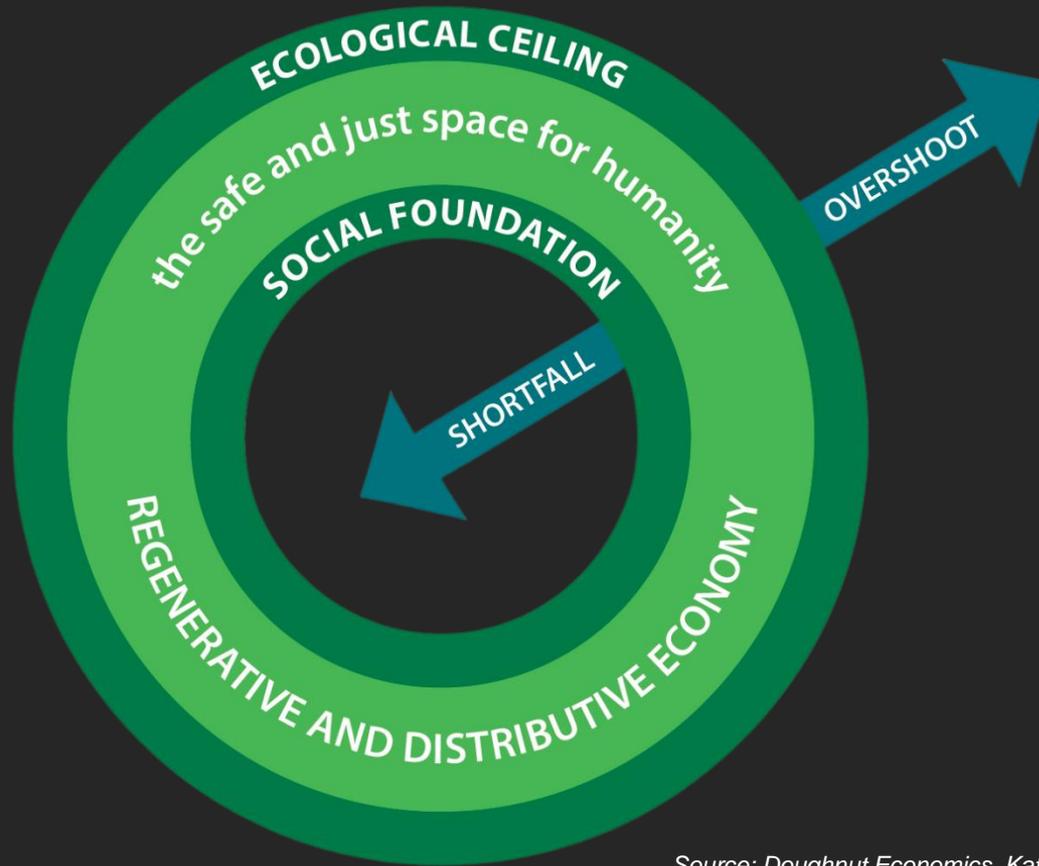
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Integrating sustainability
into risk management
and portfolio construction

August 2017

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Source: Doughnut Economics, Kate Raworth

EUI WUI GHG

Reporting Year

200 Liberty Street



Google Office

232.3

Energy Use Intensity (kBtu/ft²)

76

ENERGY STAR[®] Score

▶ Building Information

▶ Distribution Comparison

Download CSV

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Search by Building Address





Corporations with long-term planning have generated 81% more profits long-term from 2001-2014

McNeil & Johnson, The Elephant in the Room: Helping Delaware Courts Develop Law to End Systemic Short-Term Bias in Corporate Decision Making, Michigan Business & Entrepreneurial Law Review, Volume 8 (2018)



1 – ESG is lightly integrated

2 – ESG and stewardship are broadly mainstreamed



3 – ESG, stewardship and impact are tightly managed



Sophisticated measurement



Long-term fiduciaries



Strong beliefs

Closing Carl Hess



What we have covered

Theory



Tim Hodgson

People



Roger Urwin

Culture



Brandi Wust

Industry



Bob Collie

Sustainability



Jennifer Kruse

...we didn't have time to cover these

The asset class of tomorrow	Investment as an ecosystem
Decision making	Long-horizon investing
Diversity	State of the industry
Enhancing DC	Sustainability beliefs
Integrated reporting	



...in 2019 we are covering these

Research topics / working groups

The asset classes of tomorrow
DC member engagement
Sustainable investment
Total portfolio approach
Universal ownership

Workshops

Culture
Decision making
Long-horizon investing
Sustainability beliefs

Power of culture study

Linking culture and leadership, vision and strategy, inclusion and diversity

- Aimed at organisations that wish to:
 - Understand, measure and shape their own cultures
 - Be empowered to innovate around leadership, diversity and inclusion
- The study involves:
 - Applying the Institute's proprietary research
 - Your own customised culture *dashboard* report
 - Examining the potential in leadership, inclusiveness, openness and innovation
 - Follow up conversations on your cultural state and aspirations
 - Inclusion in a white paper write-up and peer group
 - Participation in a symposium with other participants
 - A subscription fee covering Institute costs alone

Share in the power of culture to support greater purpose and better outcomes

What sort of organisations become members



They are **innovative** and **inquisitive**...

...and want the opportunity to **engage** with us on **trends, context, new thinking** and **its application** to their futures...



They are **client / member-focused**...

...and want the chance to **deepen their understanding** of what the leading **investment organisations of tomorrow** want and need...

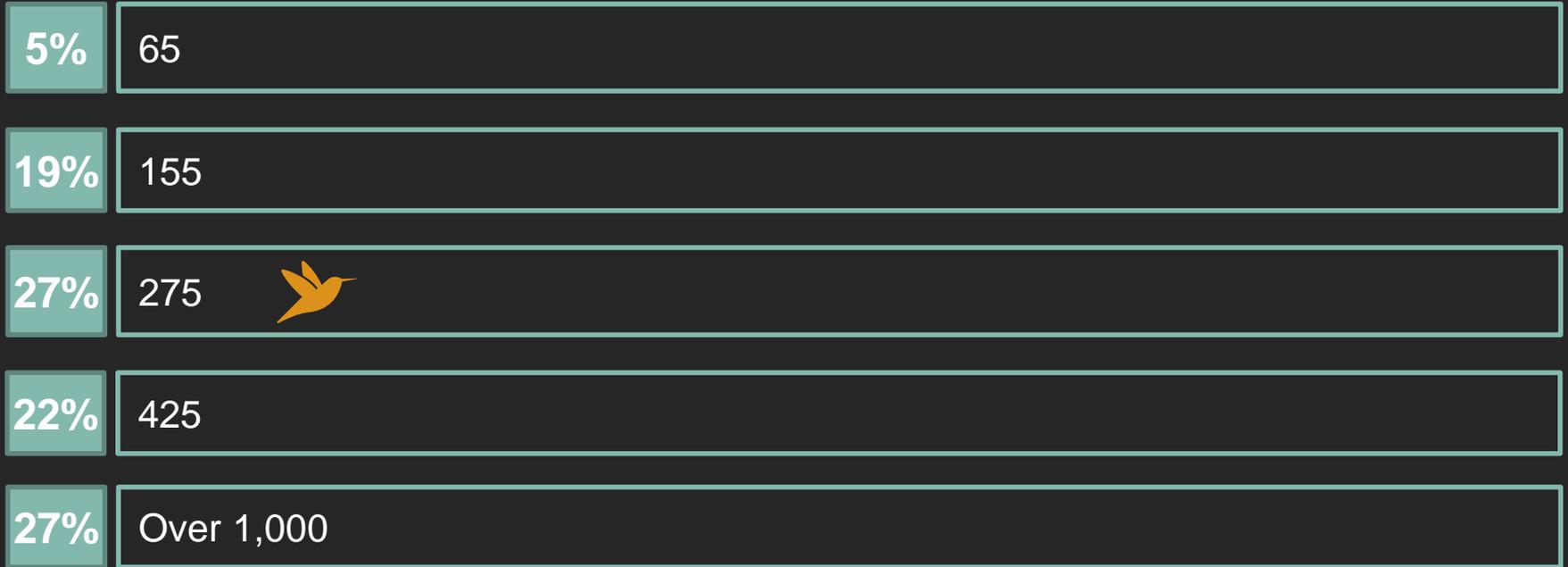


They have a **purposeful culture**..

...and are up for **contributing to the industry through giving and getting** within the Institute...

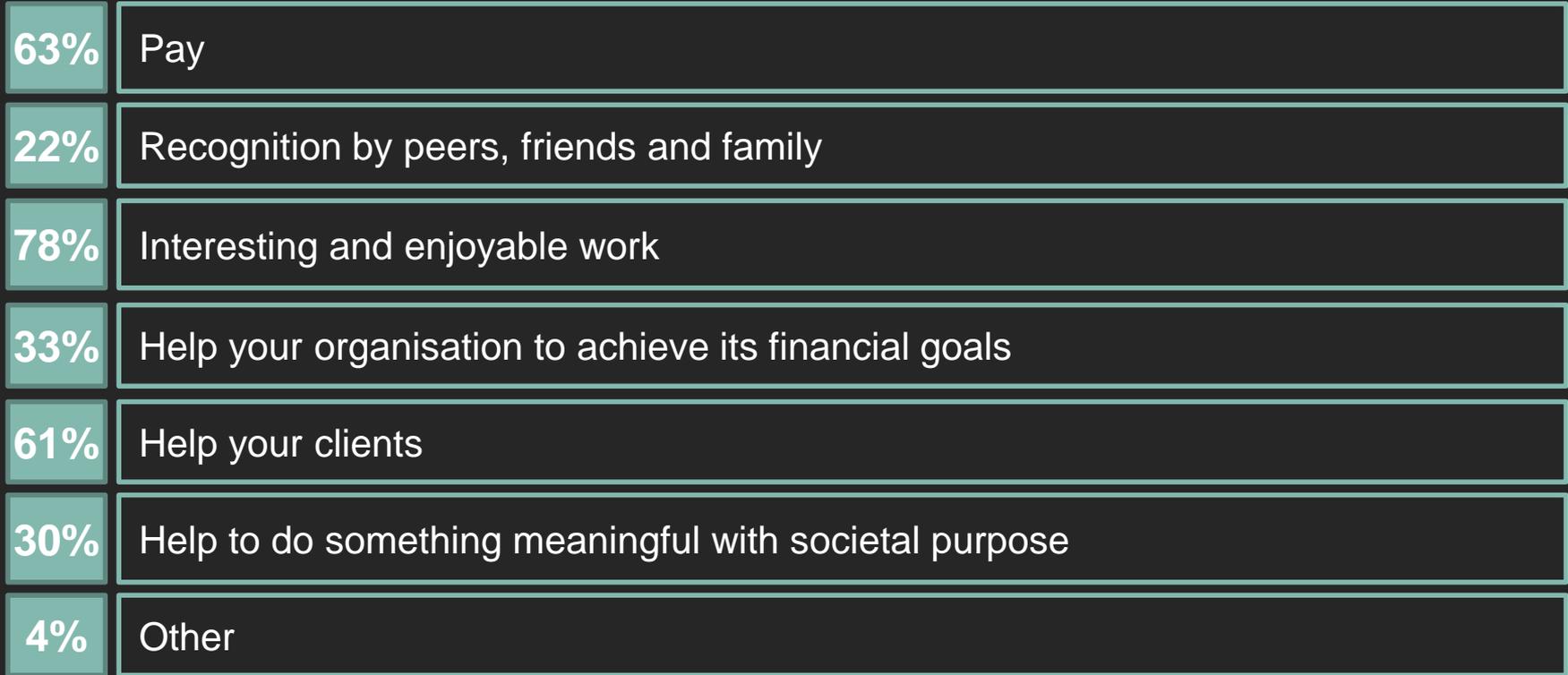
Closing questions

Q1. How many species of bird have been spotted in NYC's Central Park?



Closing questions

Q2. What motivates you to perform in your current role? (Pick your top 3 choices)



Closing questions

Q3. To judge the strength of an organisation, culture tells you more than strategy?

43% Strongly agree

45% Agree

11% Neutral

2% Disagree

0% Strongly disagree

Closing questions

Q4. What is the current pace of action on inclusion and diversity?

33% Far too slow

44% A little bit slow

19% About right

2% A bit fast

2% Far too fast

Closing questions

Q5. In the next ten years, how much disruption does the asset management industry face?

0% Less than the disruption of recent years

9% About the same as the disruption of recent years

38% Greater disruption than in recent years

38% Substantially greater disruption than in recent years

15% Very significantly greater disruption than in recent years

Closing questions

Q5. What is the current pace of investor action on sustainable investment?

23% Far too slow

66% A little bit slow

11% About right

0% A bit fast

0% Far too fast

Limitations of reliance

Limitations of reliance – Thinking Ahead Group 2.0

This document has been written by members of the Thinking Ahead Group 2.0. Their role is to identify and develop new investment thinking and opportunities not naturally covered under mainstream research. They seek to encourage new ways of seeing the investment environment in ways that add value to our clients.

The contents of individual documents are therefore more likely to be the opinions of the respective authors rather than representing the formal view of the firm.

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