Safeguarding your retirement benefits

FINAL PAPER

VIABILITY OF A MULTI MANAGER APPROACH TO INVESTMENT OF RETIREMENT BENEFITS ASSETS IN KENYA

BY

NZOMO MUTUKU

KOOME KATHURIMA

CHEROP TOROITICH

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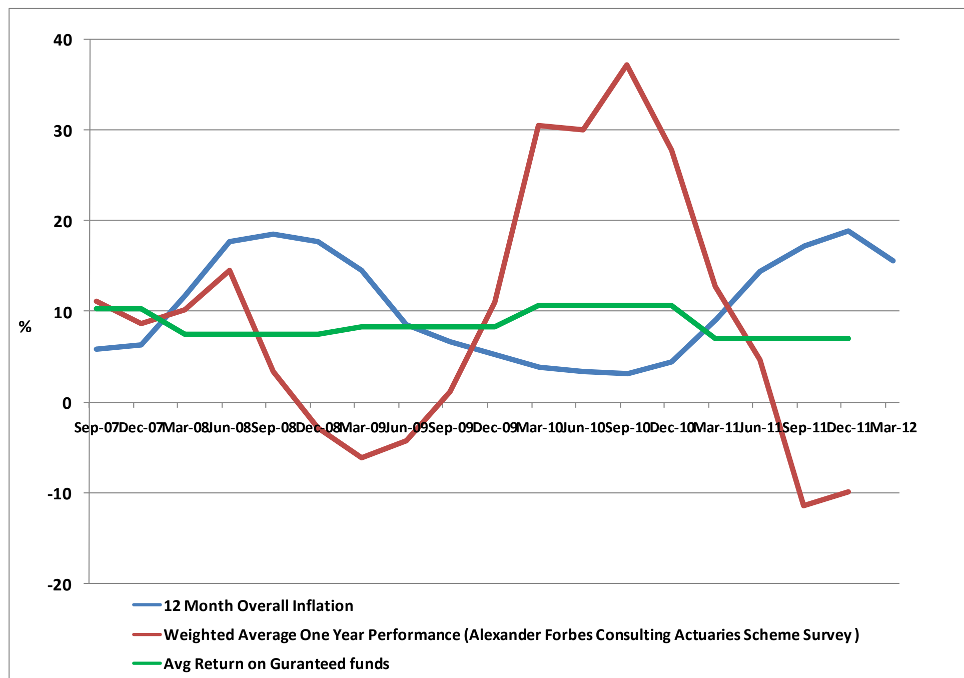
INTRODUCTION

The pension industry in Kenya has experience significant growth in the last ten years with total industry assets growing from shs 147 bn in December 2002 to shs 456 bn as at December 2012. Notwithstanding the significant growth pension industry investments have been subject to significant volatility resulting in large variation in investment performance as shown in the figure below.

Figure 1: Investment Performance of Retirement Benefits Schemes



The high volatility in scheme investment has resulted in several periods of negative real rates of return to the schemes. In addition, even schemes invested in guaranteed funds, which smoothen the volatility, have exhibited negative real rates of return for extended periods.

Given that this is a growth industry, the relatively stable and predictable character of contribution inflows and pension outflows combined potentially give trustees of

scheme funds a very wide choice of investment strategies. Therefore, there is a need to benchmark with the world best and perfect the best practices in order to help the sector to achieve growth.

Global investors have recently faced a perfect storm in seeking to achieve their long-term financial goals. Nearly five years after the world-changing financial crisis began in 2008, markets continue to experience episodic, extreme bouts of volatility, most recently related to fears over sovereign debt in Europe. The net result has been continued risk aversion among investors and more cash on the sidelines. The situation is exacerbated by meager yields of bonds, which investors might otherwise look to for a source of meaningful return (Kupperman 2012).

Majority of the fund managers manage more than one scheme. Some managers manage up to 300 schemes. Given the numbers, this raises some very pertinent questions:

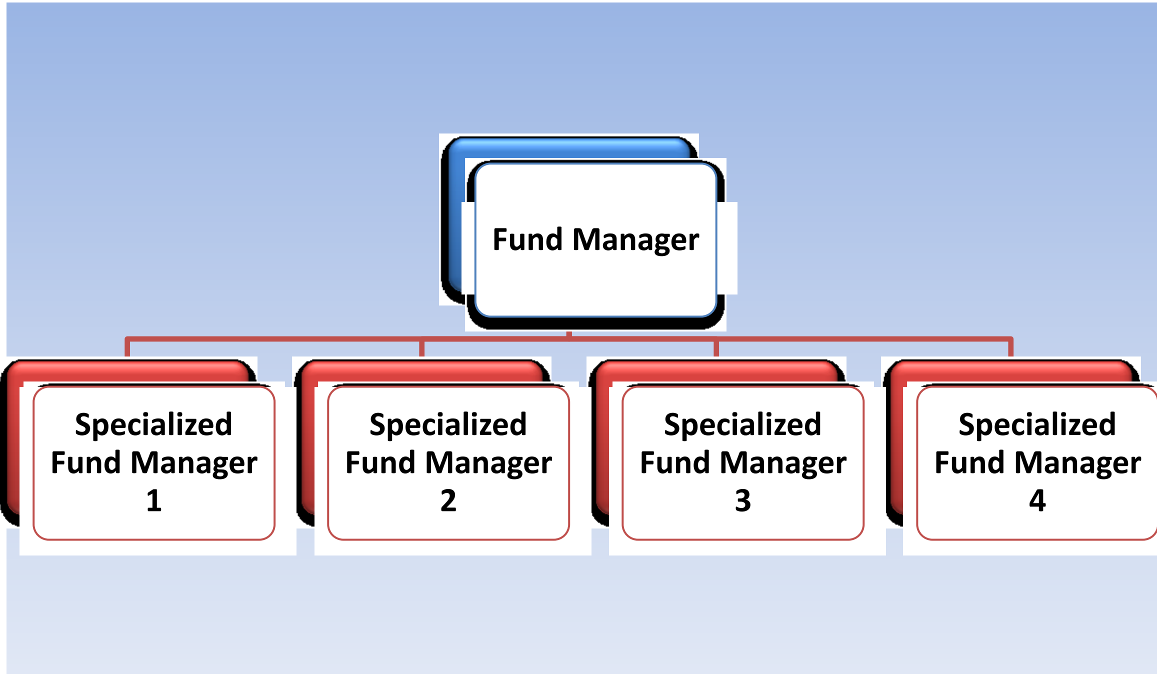
- Are they able to offer each client the best possible scenarios?
- When an attractive but limited investment opportunity arises, how does the manager decide which schemes(s) to offer the opportunity to and which to lose out?
- Are their specialization/skills being put to best use?
- Can one rely on a single fund manager to deliver well, consistently, no matter how good their track record is?

Given the nature of this challenging environment, advisors may wish to think creatively in trying to solve the challenges faced by their clients. This paper seeks to address whether a multimanager investment approach is a viable option in the investment of Kenyan retirement benefits.

As the name suggests, multi-manager funds are schemes that tap the combined skills of several fund managers in handling investors' money (Dhanorkar 2012). Multi-managers use various approaches when it comes to investment strategies and styles. This raises a further question; *which multi-manager style is best suited for the Kenya pension investment industry?* For the purpose of this research four options were considered:

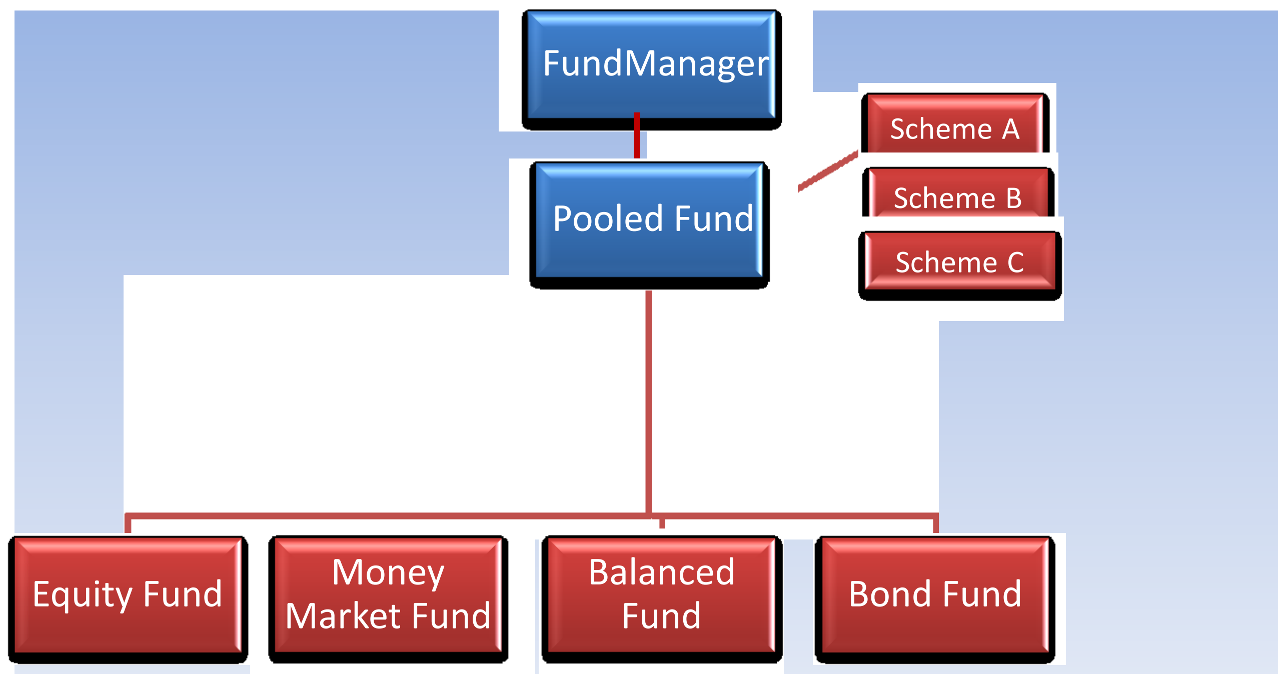
Manager of manager: This is whereby a scheme hires one overall fund manager who further hires multiple managers that are specialized in particular investment classes.

Figure 2: Manager of Managers



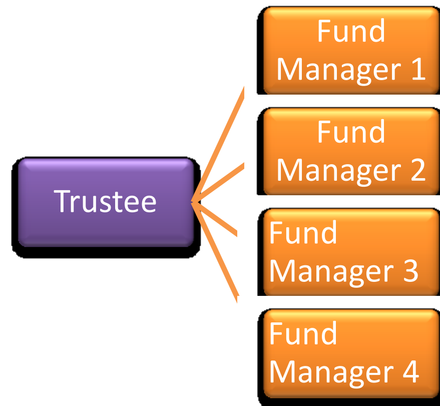
Fund of funds: In this option, a scheme employs one fund manager. The fund manager combines assets from different schemes into a pooled fund then invests in multiple funds such as equity fund, money market fund etc. This is similar to the current Guaranteed Fund set up in Kenya, but the key difference being that the Guaranteed Funds invest directly in the markets and not in other specialist funds.

Figure 3: Fund of Funds



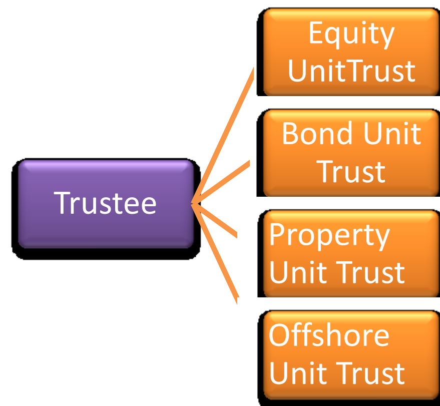
The **multiple managers** option looks at trustees of a fund hiring multiple fund managers. This will require the trustees to shop around and select the best available fund managers and the best mix of fund managers that suits their needs. Each manager would ideally specialize in a particular asset class. However, in Kenya there are currently schemes using multiple managers but with each manager having a portfolio of all asset classes.

Figure 4: Multiple Mangers



The **direct unit trust** option looks at trustees of a fund investing directly in unit trust products issued by different managers. Each unit trust would reflect a specific asset class and the trustees would invest in unit trusts issued by managers who perform best in a particular asset class. In effect the intermediary role of the manager is removed and the trustees invest directly in the unit trust.

Figure 5: Direct Unit Trust



The investment of the pension fund is the responsibility of the pension trustees. The Retirement Benefit Regulations (occupational retirement benefit schemes) 2001 provides an investment guideline under section 38. Prudent investment of pension funds is absolutely necessary in order to safeguard the pension fund member's interest (Rono 2009).

Figure 6: Summary of the Benefit Act Investment Guideline

Categories of Assets	Maximum percentages (%) of total asset value of fund
Cash	5%
Fixed Deposit	30%
Corporate bonds/Commercial Paper	30%
Kenya Government Securities	90%
Preference Shares and Ordinary Shares	70%
Unquoted Shares	5%
Off-shares Investment	15%
Immovable Property	30%
Guarantied Funds	100%
Any other Assets	10%

Furthermore, before investing scheme funds, every retirement benefits board of trustees is expected to develop an investment policy subject to the provisions of the act[1] that guides all its investment decisions. This policy is expected to maintain the capital funds of the scheme, but also to earn market rates of return for themembers (FSD Kenya 2008). The trustees of a pension fund are required to appoint a fund manager to invest and grow the fund. These fund managers must be registered with the Retirement Benefits Authority.

[1] The Retirement Benefits Act in. Section 37 as it applies to investment of scheme funds states :

Every scheme shall have a prudent investment policy on the investment of the funds of the scheme so as to maintain the capital funds of the scheme and generally to secure market rates of return on such investment

Figure 7: Registered Fund Managers as at December 2011[2]

Fund Manager	Number of Schemes Managed
African Alliance Kenya Management Company Limited	21
AIG Global Investment Company (East Africa) Limited	90
Amana Capital Limited	1
Apollo Asset Management	3
British American Asset Management Company Limited	41
Co-op Trust Investment Services Limited	117
Dry Associates Limited	3
Genesis Kenya Investment Management Services Limited	70
ICEA Asset Management Limited	310
Jubilee Financial Services Limited	125
Kenindia Asset Management Company Limited	115
Madison Asset Management Company Limited	34
Old Mutual Asset Managers (Kenya) Limited	129
Sanlam Investment Management Limited	3
Stanbic Investment Management Services (EA) Limited	168
Zimele Asset Management Company Limited	2

The pension fund manager is faced with a decision of whether to invest in the money market, real estate, government securities, stocks and offshore investment. While performing their investment functions fund managers are confronted by various challenges and risks as summarized by (Keizi 2008):

- Lack of liquidity
- Unethical behaviour among stock brokers
- High stock brokerage costs
- Inhibitive regulations
- Little focus on performance
- Limited discretion
- Trustees' limited understanding of risk-return relationship
- Limited investment products

[2] Source: RBA database

Risks faced during fund management duties;

- Inflation
- Market volatility
- Political risk
- Competition risk
- Credit risk
- Equity price risk
- Information asymmetry

2.0 OBJECTIVES

The general objective of this paper is to establish the viability of multimanager approach for investment of retirement benefits assets in Kenya. The specific objectives are to;

- To identify the merits and demerits of the various multimanager approach including:
  - Manager of manager approach
  - Fund of funds approach
  - Multiple managers approach
  - Direct unit trust approach
- To establish the number of schemes adopting multi manager approach, and reasons for and against these approach.
- To compare the investment performance of Kenyan schemes that have utilized a single manager to those using multimanager approaches.
- To identify opportunities and obstacles to adopting a multimanager investment approach in Kenya.

LITERATURE REVIEW OF INTERNATIONAL EXPERIENCE WITH MULTI MANAGER

INTRODUCTION

According to (Blake, et al. 2012) the past few decades have seen a major shift from a single to a multiple investment management style. This trend can be observed worldwide with the fastest growing markets for multimanager products comprising of; Japan, United Kingdom, Spain, Australia and the United States of America (Cerulli 2004).

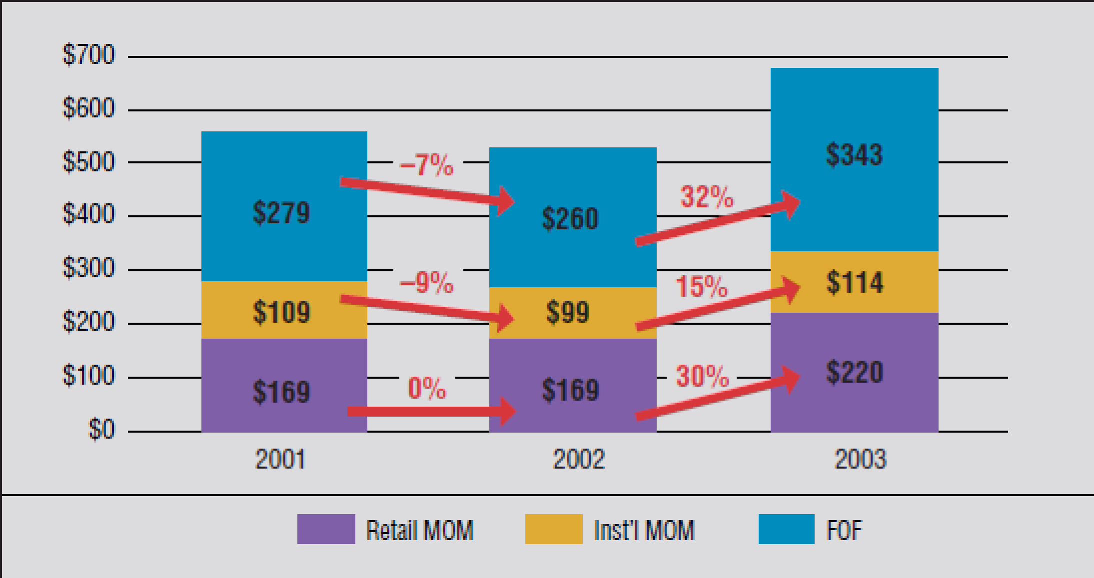
(Jaffer 2006), notes that the move towards specialization has been a major source of growth in the multimanager market. He further observes that the trend of specialization finds its roots in the USA where during the 1970s the introduction of ERISA (The Employment Income Security Act); which turned employers towards their fiduciary responsibility of offering defined benefits pensions. In order to achieve necessary returns, employees' pension funds needed more skills than the traditional single fund manager could provide. This need brought about the creation of specialist managers which consequently established multi-managers.

In Europe, the LCF Rothschild group led the way in the multimanager approach since 1969. However, the main trend did not begin till the late eighties due to the smaller pool of available assets, strict regulations and difference in financial culture.

A survey carried out by (Cerulli 2004) found that multimanager asset management products worldwide held nearly US$680 billion at year end 2003, up 28% from year-end 2002. Multimanager products include assets in *funds of funds*—collective investment schemes that in turn invest in shares of other publicly offered collective investment schemes—and both retail and institutional *manager-of-managers products,* which are

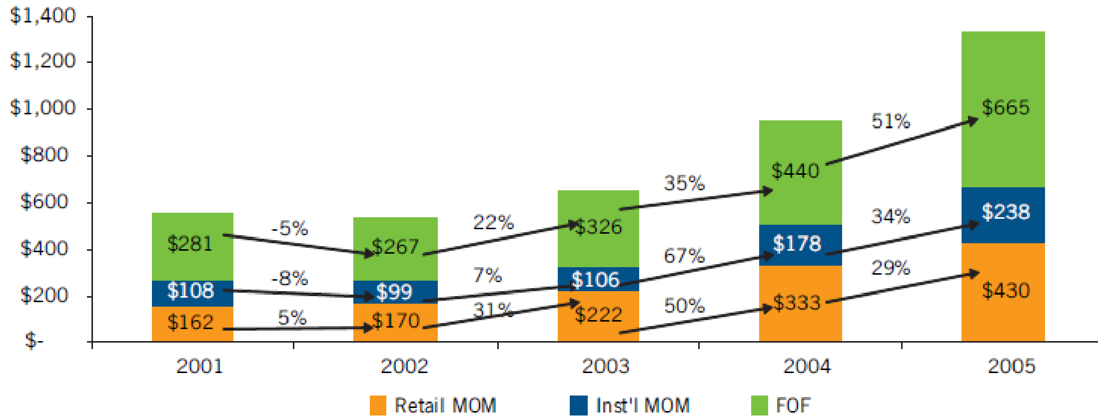
funds or institutional mandates where assets are divided among multiple sub advisors. Funds of funds accounted for US$343 billion of the total, while retail manager-of-managers funds held US$220 billion and institutional manager-of-managers products comprised US$114 billion.

Figure 8: Global Multimanager Assets under Management (US$ billions)



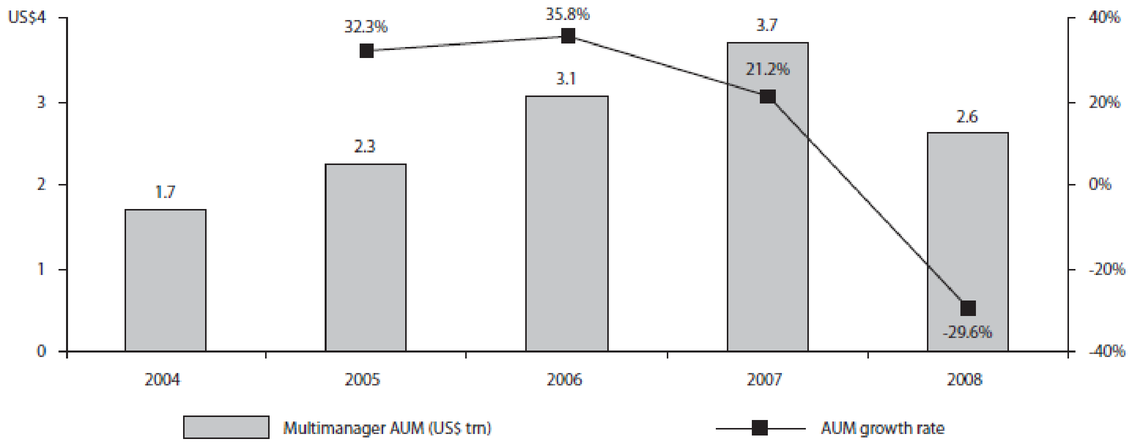
Multimanager assets worldwide have continued to grow whereby multi manager products expanded by 40% during 2005. Furthermore, assets had topped US$ 1.3 trillion as shown by (Cerulli 2007). Funds of funds' asset growth outpaced managers-of managers by 20%, with the two segments growing assets at 51% and 31% respectively. This is due in large part to the continued success of funds of funds in the U.S., the largest market for multimanager vehicles. Funds of funds are increasingly popular, particularly in lifestyle and target retirement wrappers.

Figure 9: Global Multimanager Assets under Management by Product Segment (US$ billions)



The continual growth observed between 2001 and 2005 has begun to change with multimanager assets falling by 30% in 2008 to a total of US$2.6 trillion at the year end. (Cerulli 2009), summarizes this in the figure below,

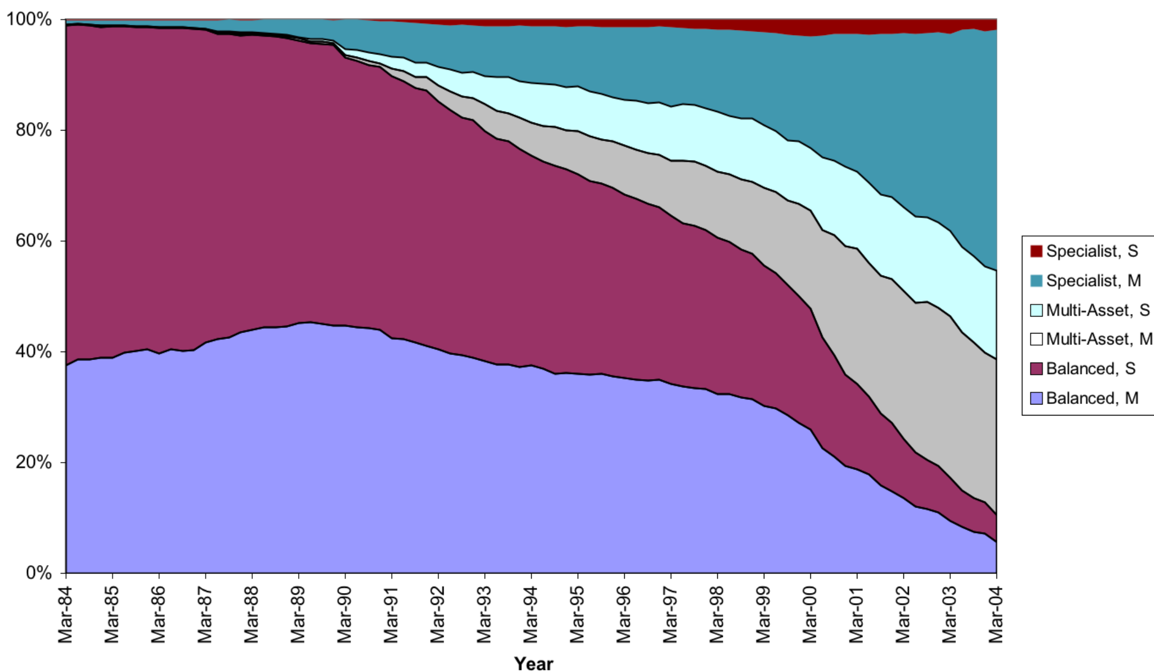
Figure 10: Global Multimanager Assets under Management, 2004-2008



UNITED KINGDOM

(Blake, et al. 2012), observes that over time, there has been an increase in the use of multiple-manager balanced mandates. Most pension fund sponsors shifted from employing balanced managers, who invest across all asset classes, to specialist managers, who specialize mostly within a single asset class; and from a single manager (either balanced or specialist) to competing multiple managers (balanced, specialist, multi-asset or combinations thereof) within each asset class.

Figure 11: Distribution of UK Equity Mandates by Mandate type and by No. of Managers 1984-2004



[3]

[3] The figure shows the evolution through time in the percentages of types of UK equity manager mandates, namely specialists, multi-asset managers (who manage more than one asset class, but fewer than all asset classes) and balanced managers (who manage across all asset classes), and whether these mandates were managed within the UK equity asset class by a single (S) or by multiple (M) fund managers.

Furthermore, the number of specialist managers per asset class has increased over the years. The distribution of funds has also increased over time towards multiple managers. According to (Legal & General (Unit Trust Managers) Limited n.d.), the total funds under management for funds of funds hit an all-time high of £60.2 billion at the end of 2011, with net retail sales at £5.2 billion. Multi manager sales accounted for £1 of every £9 invested in funds during the year with these products now accounting for a tenth of the entire UK investment industry.

Figure 12: Number of Funds and Fund managers by Asset Class

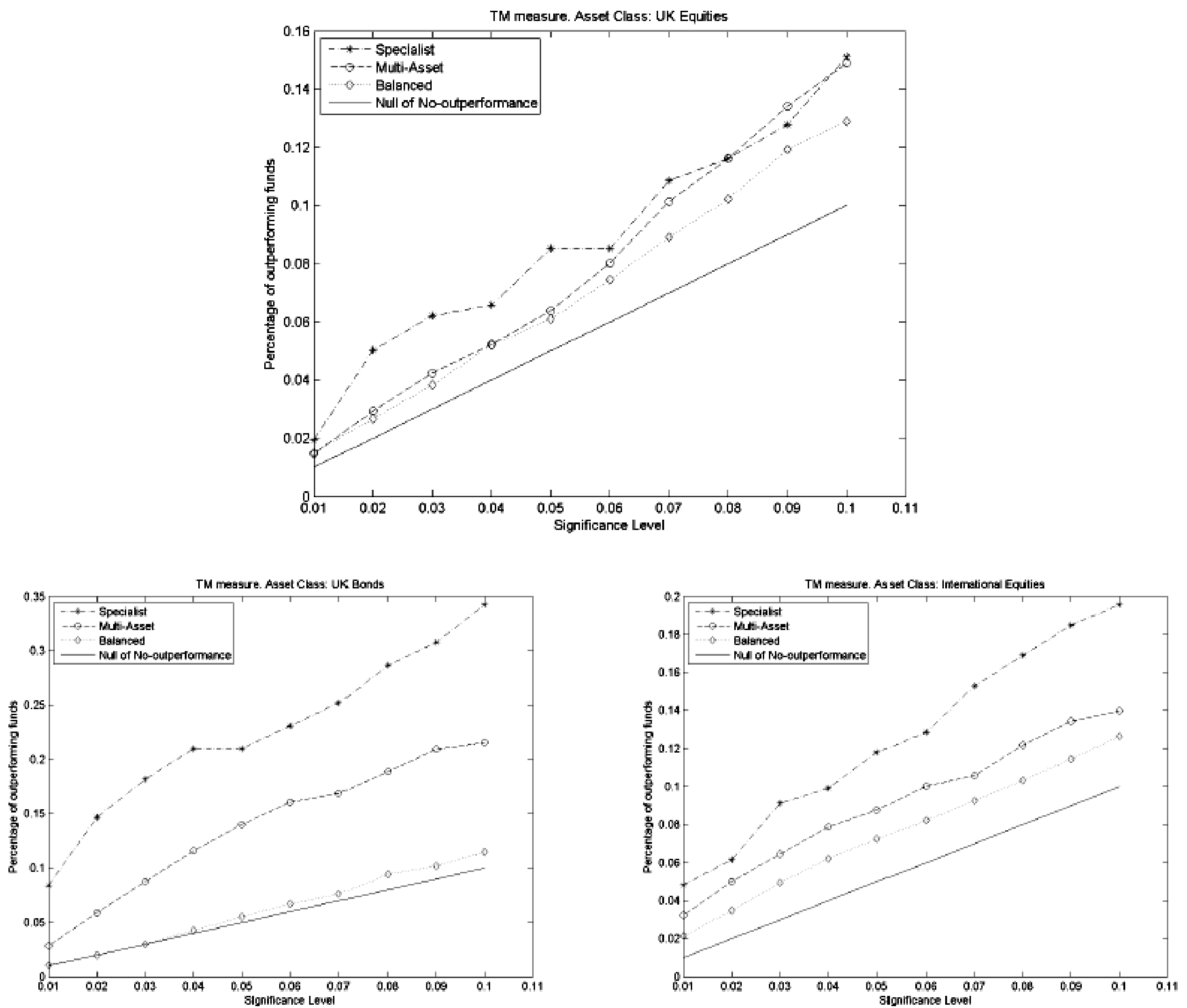
Asset	Jan 1984		Jan 1994		Jan 2004		In Existence	
	Funds	Managers	Funds	Managers	Funds	Managers	Funds	Managers
UK Equities	955	113	1044	112	630	82	2385	280
UK Bonds	943	109	652	96	612	61	2319	247
Int. Equities	911	108	1019	118	627	89	2350	279
Int. Bonds	74	22	761	75	210	41	1603	181
Index-Linked	545	75	513	76	412	48	2044	205
Cash	779	108	816	113	463	75	2351	304
Property	718	93	543	86	232	43	1657	184

Figure 13: Distribution of Funds (in millions of pounds sterling) by Number of Managers

	# of managers	Jan 1984		Jan 1994		Jan 2004	
		Mean Size	Percentage	Mean Size	Percentage	Mean Size	Percentage
UK Equities	1	30.87	80.42%	72.06	72.99%	42.44	56.83%
	2	32.01	14.76%	62.25	19.83%	45.76	26.19%
	3 or more	38.06	4.82%	129.13	7.18%	71.51	16.98%
UK Bonds	1	12.33	82.18%	8.66	87.27%	35.45	72.55%
	2	11.98	13.47%	7.80	11.35%	46.05	21.41%
	3 or more	14.64	4.35%	24.01	1.38%	51.51	6.05%
Int. Equities	1	9.83	81.34%	29.19	75.37%	35.96	64.27%
	2	13.10	14.05%	27.03	17.76%	33.01	23.92%
	3 or more	13.58	4.61%	56.69	6.87%	62.35	11.80%
Int. Bonds	1	2.49	98.65%	5.03	77.27%	6.13	79.52%
	2	1.77	1.35%	8.89	18.79%	13.42	17.62%
	3 or more	-	-	26.96	3.94%	12.37	2.86%
Index-Linked	1	2.23	87.89%	9.31	88.30%	33.40	75.97%
	2	2.88	10.46%	19.98	11.11%	34.45	19.90%
	3 or more	1.01	1.65%	21.11	0.58%	47.69	4.13%
Cash	1	1.84	82.67%	4.63	79.04%	2.03	68.25%
	2	1.22	13.35%	4.79	14.46%	3.13	21.17%
	3 or more	2.73	3.98%	9.05	6.50%	4.72	10.58%
Property	1	16.03	86.21%	14.88	90.79%	26.09	88.36%
	2	5.43	11.56%	7.89	8.66%	13.62	10.34%
	3 or more	6.38	2.23%	2.63	0.55%	12.78	1.29%

(Pension World 2012), states that, UK pension funds run by specialist managers sharply outperform those overseen by balanced managers, according to a new 20-year study in the *Journal of Finance*. Specialist fund managers, who focus on a single or a small number of asset classes, showed superior stock selection abilities compared to balanced managers, who focus on a wide range of asset classes. The superior performance of specialist fund managers was most evident among UK equities, which is the dominant asset class for UK pension funds. (Blake, et al. 2012), further supports this as observed in the figures[4] below,

Figure 14: Percentage of Outperforming Funds by Mandate Type



[4] These figures performance measures by three types of managers, namely specialists, multi-asset managers (who manage more than one asset class, but fewer than all asset classes) and balanced managers (who manage across all asset classes).

AUSTRALIA

Funds management in Australia has grown beyond the demand for specialist professionals to run portfolios of shares, property, fixed income or cash investments in a single easy-to-administer investment vehicle. This approach became increasingly popular as the retirement savings boom, coupled with a bull market that began in 1982, fuelled the explosive growth of investable assets (Cooper 2006).

The Australian financial services industry according to (Jaffer 2006), has in the last two decades moved from institutional investors using one balanced fund (observed in the 80's) to using multiple balanced funds to using specialized managers. This came about because of sector specialization by more and more fund managers therefore encouraging the establishment of new small boutique firms specializing in specific asset class.

He further says that the Australian investment management industry has developed to a point where most investors accept the fact that outstanding performance requires focus and specialization.

According to (Chant West 2003), a silent revolution has taken place in recent years among Australia's largest financial institutions. One by one, they have abandoned their exclusively in-house approach to investing superannuation money and have introduced multi-manager products to the market. Multi-manager has become the norm with corporate funds, industry funds, public sector funds and corporate master trusts, which represent over 60% of industry assets. As a result, most Australians' superannuation fund is being invested by some of the world's leading managers, including some they may never have heard of and would never have been able to access otherwise

SOUTH AFRICA

A wide variety of unit trust funds are available in SA and there are increasingly varied ways of purchasing them. In their simplest form, units in a unit trust can be purchased directly from the unit trust management company (Manco). According to(South Africa Savings Institute n.d.), unit trusts are broadly categorised according to their investment mandates. In addition to purchasing unit trusts directly from the management company, there are now several alternative routes into unit trusts, such as those offered by the linked-product industry.

- **Linked-product Industry**

  The linked-product industry is fast becoming the preferred route into unit trusts and already accounts for over 45% of new investment inflows in South Africa. In this arrangement, the linked product provider (LPP) acts as a central administrator of unit trust portfolios. Instead of an investor holding unit trusts with several different management companies, they purchase all their unit trusts through the LPP who has contracts with the management companies. The LPP channels the funds through to the management companies, which then invest the money in underlying unit trusts. The LPP therefore acts only in an administrative capacity and does not have any bearing on the underlying unit trust performance. The advantage of choosing an LPP is that the LPPs have structured a wide range of products, such as retirement annuities, pension and provident funds, life annuities and income plans, through which unit trust funds can be purchased. Unit trusts can therefore serve as the underlying investment portfolio for all sorts of voluntary and compulsory savings schemes. LPPs act almost as wholesalers of uit trusts and can therefore switch the investor from a fund of one management company to another for a very low switching fee.

- **Fund of Funds**

  A new entrant into the unit trust industry is the Fund of Funds. This product is a fully registered unit trust in its own right, but unlike the 'standard' unit trust which invests in shares, bonds or money market instruments, this unit trust invests in a collection of other unit trusts.

- **Multi-Manager Funds**

  The traditional unit trust usually has one manager who makes all the investments in that unit trust. The manager is responsible for the investment in money-market instruments, bonds and gilts, and all types of equities. The manager therefore needs to be somewhat of an all-rounder. In reality, however, some managers have a flair for niche investment areas, such as bonds, small companies, or IT companies. Instead of having one manager to manage the entire portfolio, multi-manager unit trusts employ bond specialists to manage the bond component, small companies specialists to manage the small companies component, and IT specialists to manage IT.

- **Wrap Funds**

  Another variant within the unit trust sphere is the wrap fund. This arrangement has grown as an extension to products from LPPs. Many independent brokerages manage large numbers of LPP portfolios on behalf of their clients. Running too many individual portfolios becomes administratively inefficient and brokers often consolidate all of these individual portfolios into four or five combined (wrapped) portfolios according to different risk profiles. These managed portfolios are known as wrap funds.

  The advent of capital gains tax (CGT) on 1 October 2001 has threatened the existence of many of these wrap funds. Wrap funds are not regulated entities, so they become liable for capital gains tax every time they sell out of an underlying unit trust and realise a capital gain.

METHODOLOGY

The objectives of the paper are addressed through the following methodologies:

1. A review of existing research on international best practices in use of multimanager approaches covering a number of jurisdictions including Australia, United Kingdom and South Africa.

2. In depth interviews were undertaken with a sample of investment managers to determine their perceptions and views with regard to various multi manager approaches. The interviews explored both merits and demerits of multimanager approaches as well as possible obstacles to adoption of the approach in Kenya.

3. Focus group discussions were held with a sample of scheme trustees in Nairobi, Mombasa and Kisumu. The focus groups explored the experience of trustees in the different approaches and also disucsed the merits and demerits of multimanager approaches as well as possible obstacles to adoption of the approach in Kenya.

4. A statistically appropriate sample of retirement schemes was drawn including:
   - Schemes with a single manager.
   - Schemes with multimangers
   - Schemes with managers who invest the scheme fund in unit trusts

   Investment data including asset allocation and investment performance for these categories was compared and statistical techniques used to compare investment performance across the categories.

FINDINGS

IN-DEPTH INTERVIEW WITH FUND MANAGERS

MERITS AND DEMERITS OF MULTI MANAGER APPROACH

FUND OF FUNDS {lifecycle approach}

One of the structural changes/ approaches mentioned was the life cycle approach. The life cycle approach was seen as appropriate since it enabled economies of scale, where fund managers would only report on the number of various funds that a scheme had. Life cycle funds are also important since they cater for risk appetites of various individuals in a scheme. For this to be successful, they noted a level of standardization was important so as to have a uniform definition of terms and portfolio. Three portfolios were suggested these are aggressive; balanced and conservative each representing the risk appetite of an individual.

UNIT TRUST

Other managers sampled preferred unit trusts. They felt that unit trusts would lead to quick decision making and it would be appropriate due to the large number of schemes managed by a single manager. This system will ensure that all schemes are treated fairly since they will form a large pool of resources and managers invest as a pool. In order for the system to thrive, there was a call for more disclosure by the fund managers to allow either trustees or individual members make informed decisions. The valuations should be published on a regular interval for stakeholders to be well informed. The system will also make it possible for individuals to move from one fund manager to the other with ease.

Another advantage of the unit trust is that all schemes are accorded the same level of expertise. Since they are investing as a pooled fund the manager gets to make decisions on the basis of the pooled fund other than on a scheme to scheme basis.

SPECIALIZED MANAGERS

Majority of the fund managers interviewed felt that Kenya was not ready for specialized fund managers given that the capital market investment products was still narrow and shallow. Similarly, measuring performance for comparative purposes would be difficult; trustees may not be able to evaluate fund managers performances. It was noted that with the growth of other systems, the standardized system would then automatically apply to the Kenyan market.

For this system to work well the trustees of the schemes should be well knowledgeable and understand the environment in which they are working on so as to make the right decisions. There should be a mechanism that will enable them make informed decisions, such as a good valuation system that would be able to value the different fund managers according to their specialization.

CHALLENGES AND OPPORTUNITIES

Many of the fund manager faced different challenges in their capacity as scheme fund managers. Majority of the fund managers interviewed observed that quarterly meetings with Trustees were too frequent and time consuming. They observed that the quarterly meetings had made trustees to focus on short terms investments rather than long term investments. The trustees were mainly driven by the schemes returns rather than long term investments. They also noted that quarterly meetings were a waste of resources and talent since staff had to dedicate their time attending meetings rather than doing research which would develop the industry. The managers felt that they should not be obliged to make appearances to all the meetings, other forms of communication such as emails and presentations to trustees on a yearly basis were mooted.

Furthermore, managers are currently experiencing inefficiencies in the doing business and are looking at structural changes that can improve the way they do business to make it efficient and effective. Fund managers use investment policies as the schemes plan on investment. Where a scheme has several managers the same investment policy is used albeit fund managers allocating different percentages in each asset class. Many

of the managers managing schemes that have more than one manager say that there is no value added in terms of performance of the fund because there is no diversification and the various managers are implementing similar IPSs.

Although the schemes might benefit by diversifying their scheme assets to the different managers hence reducing the overall risk of the scheme, they felt that it would increase transaction costs to the scheme[5] that would increase the direct and indirect costs of having multiple managers

In spite of the current multi manager challenges, majority of the fund managers welcomed the concept of introduction of multi managers in pension funds. The general feeling was that it would be able to reduce the cost of doing business if there was a positive response in the sector where managers would be more innovative.

It was further reiterated that multi- manager approach would only makes sense if different managers have different strategies in terms of management of funds.

[5] Increased transactions costs may arise due to lack of coordination where one of the fund managers is disposing off equities while the other is purchasing the same equities. The scheme would be charged brokerage fees in both cases.

FOCUS GROUPS WITH TRUSTEES

MERITS AND DEMERITS OF MULTI MANAGER APPROACH

UNIT TRUST

The general opinion of trustees was that unit trusts are a good way of investment albeit it being risky. Due to the reflection of daily prices, members are able to make better decisions on their investments and are able to calculate their balances and what they need to do to get a good return for their retirement.

Despite it being viewed as a very professional way of investing, the public has not fully embraced it. They felt that it would be riskier for an individual trustee in comparison to a corporate trustee. There is a need for further research and exposure to unit trust. Furthermore they felt that it would be necessary to have good regulations and guidelines in order for unit trusts to be effective.

When asked if they would be more open to the idea of unit trust if structured in compliance with the RBA guidelines, the trustees were more receptive to it. They acknowledged that it would be a good idea as long as it was properly structured and does not compromise the overall performance of the funds. It was also felt that it can only work if there was a guarantee otherwise it would not work.

Additionally, they were of the opinion that larger schemes should be excluded from entering into unit trust and focused more to the smaller schemes. There should also be a cap generated on the total fund values of a scheme that will invest in unit trust

On directly investing on unit trust without the use of a fund manager, the trustees were of two varying opinions:

1. It would assist in profit maximization as it would cut out intermediaries thus reducing cost.

2. Doing away with fund managers would expose the scheme to risk as majority of the trustees don't have technical knowhow in investing.

SPECIALIZED FUND MANAGERS

Most trustees were not open to this model. They felt that it was not ideal with the present investing environment. Currently, the idea might not be good because very few fund managers are specialized in particular investment classes.

The cost implications to the scheme would be high and this will give way to further complications. In the event that the portfolio is adversely affected it may ruin the scheme. It was also seen as a waste of resources which would be otherwise placed in other areas of the fund. It was also thought that if introduced, it would only work best for established schemes with high fund values.

As long as it was not mandatory a few trustees thought that it was a reasonable model. It was observed that since the fund managers that would be employed would be specialized it would lead to better returns for the scheme. They felt that returns on investments would be positive and would be likely to increase.

In order for this model to work, trustees felt that the authority should put good structures and controls that would enable this system to work. They reiterated that investment in good structures was very important.

FUNDS OF FUNDS {Lifecycle approach}

The trustees felt that this was positive model. However they did not see it as something new and felt that it was not that much different from what we currently have. They felt that the results would be good over a prolonged number of years. The downside of it is that if you don't get it right, it will trickle down to members through low returns. In addition, lack of prudence would lead to serious effects.

CHALLANGES AND OPPORTUNITIES

While many agreed that the area of investment was challenging, they said that regular meetings were of assistance to them. Most of the trustees said that they had to establish investment committees who would have regular meetings with fund managers. The committee will be responsible for ensuring that they monitor the market from time to time, make sure that the benchmarks are kept by the fund managers and have quarterly meetings with fund managers where they evaluate their performance.

There are individuals in the committee whose responsibility is to monitor daily activities of the market. While measuring performance they will look at the inflation rate as well as the economy as whole on its performance. This is done by looking at whether the benchmarks in the investment policy have been met by the fund managers and using other benchmarks in the industry to compare the performance of the scheme to other schemes in the industry.

The trustees also set up meetings with other service providers to be able to see how the scheme operates. They make sure that they have meetings with administrators, auditors, and custodians on the presentation of reports on the state of the scheme. They additionally compare the reports from different providers where they engage the actuary to do a separate analysis of the industry performance as well as the report of the in house administration. These two reposts are compared with the fund managers report to see on how the scheme has performed.

One of the biggest challenges in performance was that there was no clear way or method in which to measure this performance. Although schemes had investment policies in place which had benchmarks that were agreed upon by the managers and the scheme, it was unclear whether schemes were able to perform as well as or more than the industry at large. It was felt that in schemes that had more than one fund manager, the trustees were able to use the returns made in one manager to gauge the other manager's performance.

The trustees called on RBA to ensure that there is a standard way in which the performance of fund managers was measured. They highlighted that in the guaranteed schemes it was easy to know the best and worst performers since the fund managers published yearly rates of return that were public and schemes can use for analysis. However more trustees were satisfied with their managers, since they were able to accomplish the benchmarks set.

Insufficient knowledge on investment issues was one of the challenges observed in reviewing investment performance. Due to this conundrum, the trustees are forced to heavily rely on fund managers and other service providers. Trustees are therefore unable to contribute effectively in meetings and ask relevant questions that are necessary to investigate on the performance of the scheme. They felt that there is need to empower trustees in terms of understanding of investment issues. It was suggested that RBA should have trainings for trustees on investments, alternatively, a common training organized by various fund managers to trustees.

Another issue that arose from discussion was that of performance based fees. The trustees questioned which was the best way for schemes to pay the fund managers. Most of the trustees were of the opinion that a standard way of payment should be instituted so that managers would be competing on performance other than who

charges the least cost without looking at the outcome. Some of the trustees felt that investment returns in most instances were determined by how schemes paid the fund manager. When it is based on performance based fees, most managers would then ensure that they do more than the target to get bonuses. In the corporate world it is the norm to link payment to the performance of a service provider hence fund managers should not be an exception. It was further suggested that RBA should be able to publish the fee charged by fund managers, that way trustees will be able to know whether they are overcharged or undercharged.

Other challenges that were discussed included:

- Issue with interest earned by scheme because despite length of time the scheme would receive the same returns.
- Scheme not offering alternatives for investment.
- Difficulty in changing from a guaranteed fund to a segregated fund despite guaranteed funds having for a very long time given below average returns compared to the industry at large.
- It was felt that the returns normally given by schemes do not beat inflation and in essence have not given a positive real rate of return for the last few years.

Most of the trustees noted that there were three key areas that influenced their choice of fund managers:

- **Expertise**; the knowledge and skills of the fund managers was a major factor when it came to choosing a fund manager for their scheme
- **Performance** and history of the scheme was key in influencing their choice of fund managers
- **Professionalism** of the fund managers also played a big role in fund manager selection

When asked whether they were satisfied with the performance of managers, majority said they were satisfied in the short term since the managers where able to deliver as stipulated in the Investment Policy Statements by giving returns that were discussed as benchmarks. However, they were not sure about the future returns as most reports were tabulated on unrealized gains that might change in future to be negative and therefore result in losses for schemes. It was felt that there should be safeguards that will ensure that schemes are not heavily invested in equities and government securities. Also it helps to have board of trustees who understand who have the knowhow either in finance or accounting.

Some of the trustees felt that managers did not do their best in offering different investment opportunities and hence should be encouraged to have good research teams that will offer members good returns.

DATA ANALYSIS

Data for invested performance was compared for schemes using a single manager as compared to those with multi managers. The number of schemes with multimanagers is indicated in Figure 15 below.

Figure 15: Schemes with Mulit Managers

Number of Manager	Schemes
1	1347
2	43
3	6
Total	1396

Time Weighted Return (TWR) data was obtained from statutory submissions to the Authority from various managers for the period upto December 2011. The data was clustered to obtain weighted investment performance for schemes with only one manager as compared to those schemes with more than one manager. Figure 16 compares the weighted average 1 year and 3 Year TWR for schemes under each manager taking into account whether that scheme has one manger or multi managers.

Figure 16: Scheme Performance (Time Weighted Return) by Number of Managers as at December 2011

Manager	No. of Mangers of Scheme	No. of Schemes	1yr TWR, %	3yr TWR, %
Coop Trust	1	75	-12.4	6.8
	2	5	-12.7	6.4
	3			
OMAM	1	86	-4.6	31.8
	2	7	-4.4	33.0
	3	1	-5.8	26.7
CFC Stanbic	1	33	-6.8	27.3
	2	6	-9.3	28.8
	3	3	-5.5	30.6
Zimele	1	1	0.5	16.9
	2			
	3			
ICEA	1	18	-9.1	9.6
	2			
	3	1	-5.4	12.8
Pinebridge	1	23	-9.3	8.5
	2	9	-9.9	8.8
	3	2	-7.7	10.5
Genesis	1	51	-11.6	7.3
	2	8	-12.0	7.5
	3	2	-14.0	6.5
African Alliance	1	6	-5.3	5.6
	2	4	-6.4	8.3
	3			
ALL	**1**	**293**	**-7.3**	**14.2**
	2	**39**	**-9.1**	**15.5**
	3	**9**	**-7.7**	**17.4**

The data in Figure 16 does not show significant performance difference between those schemes having more than one manager compared to those with a single manager. For the one-year performance, schemes with multi managers have on average performed worse than those with a single manager, whereas for 3 year performance, schemes with more than a single manager have performed slightly better. This better performance could be as a result of managers paying more attention to those schemes with mulit managers due to the competitive element or possibly due to specialization into particular asset classes. However, the available data is not sufficient to test these hypotheses. In addition, there was no way to confirm that the managers had indeed utilized the recommended international standard approach in calculating the Time Weighted Approach. The data for 2 of the managers for the 3 year time weigted return seemed inordinately higher than that reported by the other managers.

CONCLUSIONS

MERITS AND DEMERITS OF MULTI MANAGER APPROACH

UNIT TRUST

There was evidence show that trustees looked more favorably to this approach. Due to reflection of daily prices member will be able to make informed decisions on their investments. It would suit the smaller schemes as they would be able to pool their funds. Unfortunately it will also be riskier especially to individual trustees.

It is apparent that fund managers highly favor this approach. It would lead to quick decision making and would be appropriate for single managers with a large number of schemes. In addition, this approach would ensure fair treatments of all schemes as managers will invest as a pool of resource. Schemes would be provided with the same level of expertise. There was no evidence that found this approach to be disadvantage.

Direct unit trust is not favored by both fund managers and trustees. Even though it would cut intermediary costs, it would expose the scheme to risk.

SPECIALIZED MANAGERS

Both fund managers and trustees did not favor this option. They felt that Kenya was not ready for this approach given that the capital market investment product was still narrow and shallow. The cost implications to the scheme would be too high. Additionally, in the event the portfolio is adversely affected, it may ruin the scheme. It's seen as a waste of resources and would only work best for established schemes with high values. Also, measuring performance would be difficult and trustees would not be able to compare fund managers effectively.

FUND OF FUNDS {Lifecycle Approach}

The general view was that results would be felt over a prolonged period of time. It was seen as appropriate as it enable economies of scale and would cater for risk appetites of various individuals in the scheme. However if it is not done right, it would incur low returns.

OPPORTUNITIES AND OBSTACLES OF ADOPTING A MULTI MANAGER APPROACH

These new systems will encourage diversity and increase investment opportunities. It will also create a scenario where fund managers will be able to give better services to their clients. It would give rise to elite trustee that would also be more aware of the investment environment.

Trustees would need to be more knowledgeable and understand the investment environment thus more education would be needed. It would increase risk that may not be favorable to the fund. Also, increased transaction cost would be a challenge as more funds might have to be released in order to employ these systems.

INVESTMENT PERFORMANCE SINGLE VS MULTI MANAGER SCHEMES

No clear investment performance differential could be discerned from comparing the TWR of schemes with a single manager and those with multi managers. There was a slight out-performance over three years of schemes with multi-managers but the data was not sufficient to confirm the significance of these findings.

Generally a multi manager approach is not a viable option for the Kenyan investment environment. The Kenyan market requires a significant growth and introduction of newer asset classes. Furthermore, fund managers would require further knowledge and expertise in order to apply this approach. However, unit trust seem a promising notion and is viable based on the maturity of the Kenyan market, performance and expertise available.

POLICY RECOMMENDATIONS

1. The Authority should put in place a mechanism to ensure that there is a standard way in which fund managers calculate the Time Weighted Return earned by schemes investing through the segregated approach.
2. Once standardisation is achieved, the Authority should publish the performance of each of the managers for segregated scheme portfolios in accordance with the Time Weighted Returns reported.
3. Further education of trustees in matters to do with investment should be undertaken as current capacity levels on investment appear insufficient to effectively implement a specialized manager approach.
4. The Authority should work with the Capital Markets Authority to encourage managers to create Unit Trusts that Schemes can invest in. This will enable easier implementation of life cycle funds and provision of investment choice to members.

LIMITATIONS OF THE STUDY AND AREAS FOR FURTHER RESEARCH

The study was limited by lack of comparable data on investment performance from different managers. This will be necessary for effective comparison of the performance of those schemes using a single manager with those using a multi manage approach.

Once standardization of performance reporting is done and data is available for at least 3 years, then another study should be undertaken to effectively establish the impact of using multi managers on scheme performance.

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ANNEXES

ANNEXE 1

INDEPTH INTERVIEW GUIDE

SECTION ONE: CURRENT STATE IN FUND MANAGEMENT

Let's start by discussing about what the duties of a pension fund manager are; what duties do you perform as a fund manager? How long have you been involved in pension fund management?

- How many schemes do you serve?
- To the best of your knowledge what would you say is the approximate total size of the pension fund?
- What would you say drives you when making scheme investments? Have you been able to achieve your goals as a fund manager?
- What would you say are the underlying issues you face when in it comes to fund management? Now that you have identified the issues do you have any suggestions to overcome them?

SECTION TWO: MULT MANAGEMENT

Introduce multiple management approaches. What is your interpretation of a multi manager? What are your thoughts on each approach?

- What are your thoughts on the use of multiple managers? Has a scheme hired you to deal with a certain percentage of their fund as opposed to the whole fund? To the best of your knowledge how many schemes have hired you in this capacity?
- What are your thoughts on unit trusts? Explain the reasons both positive and negative as well as the opportunities and obstacles in investing in unit trusts.
- Do you invest in unit trusts? Which unit trust trusts do you invest in? What led you to choose the particular unit trust?
- What are your thoughts on specializing in particular assets? Explain the reasons both positive and negative as well as the opportunities and obstacles in specializing in particular assets.

- Do you specialize in particular assets? Which assets do you specialize in? What led you to specialize in these assets?

- What are your thoughts on sub contracting to specialist managers? Explain the reasons both positive and negative as well as the opportunities and obstacles in sub contracting to specialists.
- Do you sub contract to specialist? Which assets did you sub contract? What led you to sub contract?

- With your experience dealing with trustees, do you think they have sufficient knowledge when it comes to making scheme investment decisions? Are they knowledgeable enough to perform the fund management by themselves?

- Do you think the number of managers a scheme has an affect the performance of a fund? Would changing from a single manager to a multiple managers improve or deteriorate fund performance? Explain reason.
- Is multi-management a promising practice to address fund management issues? Is it a viable approach to Kenyan retirement benefits investments?

ANNEX 2

FOCUS GROUP GUIDE

Introduce moderator and assistant

Topic is: VIABILITY OF A MULTI MANAGER APPROACH TO INVESTMENT OF RETIREMENT BENEFITS ASSETS IN KENYA.

You were selected at random from list of trustees in Kenya

Guidelines

No right or wrong answers, only differing points of view

We're tape recording, one person speaking at a time

We're on a first name basis

You don't need to agree with others, but you must listen respectfully as others share their views

We ask that your turn off your phones. If you cannot then put on silent and if you must respond to a call, please do so as quietly as possible and rejoin us as quickly as you can.

My role as moderator will be to guide the discussion:

- How do you review your investment performance?
- What benchmarks do you use? Explain reasons why.
- What would you say are they underlying issues when it comes to making investment decisions? Now that you have identified the issues do you have any suggestions to overcome them?
  - What are your thoughts on unit trusts? Explain the reasons both positive and negative as well as the opportunities and obstacles in investing in unit trusts.
  - What do you think of each of these approaches? (Both positive and negative as well as possible opportunities and obstacles of each):
    1. One overall manager who subcontracts to multi managers that each specialize in a particular asset?
    2. A single manager who combines assets from different schemes into a pooled fund then investing in multiple funds?
    3. Trustees employing multiple managers who specialize in a particular asset?

4. Trustees directly investing in unit trusts issued by different fund managers?

- ❖ Do you think the number of managers a scheme has an affect the performance of a fund? Would changing from a single manager to a multiple managers improve or deteriorate fund performance? Explain reason.
- ❖ Is multiple-management a promising practice to address fund management issues? Is it a viable approach to Kenyan retirement benefits investments?
- ❖ What is your view on investing in Private Equity as an alternative investment
- ❖ In your opinion, has Kenya's Capital Markets provided appropriate instruments and a conducive environment for the growth of alternative investments?
- ❖ In your opinion what opportunities exist for the growth of alternative investment markets both currently and in the future?