IMI Consultants Congress — April 1998
Executive Summary

Conference Description

The annual IMI Consultants Congress was held April 20 — 21, 1998 in San Francisco, covering topics from Getting Into Tomorrow s Searches to Differentiating Your Firm in a Competitive Market. Fourteen sessions were held with two-to-three consultants participating on each panel. In total, 34 consultants attended the conference. Attendees of the conference ranged from institutional and private investment managers to client service and marketing professionals; 108 attendees in all.

Highlights

- Plan sponsors are thinking about protection: they have made a lot of money (more than they ever expected) and they want to protect it now. This could be why alternative investments are taking hold.
  - An IMI survey found 34% of consulting firms are offering alternative investments
  - Endowments/foundations have a solid interest in alternative investments (30% - 40%)
- Other areas of current activity are:
  - Plan sponsors are staying with their long-term allocations and rebalancing to their initial benchmarks
  - Fixed income
  - Greater interest in small cap over large cap, including strong interest in mid cap
- Plan sponsors are asking how much money can we save? Hewitt Associates sees defined benefit plans and defined contribution plans using the same money managers. Combining the two plans saves money.
- For defined contribution plans, plan sponsors are moving toward separately managed accounts valued daily (cost less than mutual funds)
  - Increased education for 401(k) plans
- Consulting firms are moving toward asset-based fees
- Consultants count on investment managers to keep them updated on trends, especially technology
  - Consultants constantly advise their clients on market conditions; therefore, consultants appreciate hearing about market changes from the managers
- Investment firms should not present their management style as a product; makes it difficult to differentiate your professionals; process; etc.

Summaries of Consultant Presentations

Introduction
Russell K. Mason, President
Investment Management Institute

- An IMI study found an 18% annual turnover among plan sponsors, consultants and investment managers. With such high turnover, positive results in relationship building proves to be more difficult.
- The consultant arena is growing:

	Low	Mean	High
Clients per consultants	7	8	32

- Plan sponsors are requiring more from consultants in terms of services.
- Two areas of increasing focus are hospitals and high net worth individuals.
- Many high net worth individuals are currently unhappy with their investment managers; they are concerned about the ability of their assets to increase as the number of children in their families increases
- In 1997, consultants performed 15% of their searches (excluding public fund searches) with zero RFPs; up from 4% five years ago

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Getting Into Tomorrow s Searches
Consultants are working with managers to assist plan sponsors in reviewing the variety of investment products coming to market. How is the review process changing?

Tim Murphy, Consultant
Hewitt Associates
(Alliances: Picking Your Spots and Making Them Work)

- 401(k) participants want to know values daily
- Mutual funds are becoming the vehicle of choice
- Hewitt pioneered alliances ; they asked 401(k) administrative services to share costs
- Hewitt presently has 25 investment partners
- As alliances grew, plan sponsors wanted more services provided
- Result: everybody s paying everybody

- Hewitt suggests you do not have to create a mutual fund to win business in the large market. Separate and commingled funds are still attractive. Larger plans are looking at the total cost of their defined contribution plans.
- In a survey conducted by Hewitt Associates, the average number of options offered in defined contribution plans rose from 3 to 4 options in 1991 to 8 options in 1997. More plans are continuing to add options, along with an increase in the amount of plans offering window, or self-directed investment, which is a group of many funds usually branching into specialty asset classes.
- Tiered group of funds
- Time horizon; group of life cycle funds
- Assets from both plans or pooled
- Moving to institutional class of shares
- Hewitt offers a wide variety of services and advice. Ultimately, the client decides the alliance; where the money goes, etc.
- Target market alignment is important to understand before approaching an alliance; caution regarding sleeping with the enemy
- Realistic game plan toward alliances include:
  - Market segment
  - Open/closed structure
  - How manager evaluation process works
  - Whether alliance provider is growing, stagnant, or declining; and management of the alliance relationship accordingly
  - Open communication is critical to success
  - Remember to advise defined benefit consultants
  - Remember non-traditional consultants

Russ LaMore, Consultant
Hammond Associates

- Hammond focuses on asset allocation decisions and tends to hire mostly index managers
- Reviewing RFPs is not done often; they have a stable of managers from which they update their short lists one to two times a year. (They also review them each quarter.)
- To help managers get into tomorrow s searches, key areas of concentration are:
  1. Differentiate yourself
     - Make what you do sound interesting
     - Provide your quarterly update information in a unique and interesting way; use humor

- Send updates when relevant (sometimes mid-quarter)
- Send updates before quarter-end to get noticed

2. Provide easy access to your information
   - Develop a web page
     - Include historical performance
     - Describe your firm; history; process; professionals
     - Web site should house the same information you would provide in a meeting with a consultant
     - An initial meeting could take place over the phone using the web site. The consultant can view the information on your site and ask questions as they may arise.
3. Provide accurate information
   - Very important that managers ensure accuracy of information provided, especially stating AIMR compliance
   - Many managers select AIMR compliant ; but remember, consultants confirm these areas
   - Data is checked/reviewed quarterly, update accurately
4. Deliver excess returns
   - Demonstrate persistent and skillful returns
   - Define your benchmark and an acceptable tracking error

Joseph P. Karpinski, CFA, Principal
Ernst & Young

- Differentiate, differentiate, and differentiate! This is key to manager s success for getting into tomorrow s searches.
- New role of marketing is emerging:
  - Communication is crucial; the power of the message lies in the quality of the message
  - Consultants find themselves bored when managers over-use ideas and only repeat what is in the books during presentations
- Firm identity
  - Concentrate on your firm s identity
  - Use your dollars wisely
  - Outsource when necessary
- Consultants like quick one-pagers before quarter-end, including:
  - Short commentaries
  - Graphics to show where you are in universe
- Build relationships

- Relationships are built over time from good communication and updates.

Questions/Answers

1. Can a relationship really be made in 15 minutes?
   - ♦ Relationships cannot be built in 15 minutes; however, the potential is created for a long-term relationship
   - ♦ Managers need to articulate their process/products well so that the consultant truly understands
   - ♦ Always emphasize the four P s (philosophy, process, portfolio, performance)
2. How important is the use of outside databases in the screening process (i.e., when a manager leaves blanks)?
   - ♦ Hammond Associates narrows down their searches from a database; then they go to managers web sites; then they call the managers of choice. Leaving blanks could eliminate you from a search.
   - ♦ Joe Karpinski of Ernst & Young feels investment managers do not answer well enough when they complete the questionnaires for databases. When responses are inadequate, managers end up not being selected for searches.

Making Managers Competitive

Consultants are in an excellent position to make your firm more competitive. What information do they require to enhance your success in the selection process?

Harold W. Small, Principal
W.T. Kennedy, Inc.

- ♦ Working with consultants is like a marriage:
  - No matter what anyone says, performance, performance, performance is critical
  - Net of fees over long-term
  - Remember to speak in consultant s language
  - Explain firm s heritage
  - Sell your strengths
  - Explain investment process so consultant truly understands
  - Pricing
  - Service; who will come first? How much attention will you continue to provide to consultants and plan sponsors?
- ♦ Once hired, focus on:
  - Smooth and professional transitions
  - Open communication when returns are down
  - Commitment to improve service while remaining on course

- Team function

Robert Helliesen, Principal
Dorn, Helliesen & Cottle

- To be competitive, managers need to:
  - Provide strong client service
  - Develop a better product than the next manager
  - Stress diversification as a benefit
- Rules for calling on consultants:
  - Know your product
    - Bring the portfolio manager around once in a while
    - Talk like the portfolio manager if he is not there
  - Know your audience
    - Do your homework
    - Spell names correctly
  - Make meetings useful
    - Respect the consultants time
    - Share research that could help the consultants
    - Volunteer to educate consultants clients
  - Use opportunities well
    - Pounce on any requests
    - Do background checking
    - Find out who you can talk to and only speak to them
    - If you make it to a final, do even more research
  - Be philosophical
    - Not everyone wins; maybe you just did not add the right diversification

Laurence O. Gray, Chief Executive Officer
Gray & Company

(In preparation for this presentation, Larry surveyed 41 plan sponsors and seven consultants.)

Ways to be competitive:

1. Describe firm s compensation structure
   - Explain how your firm works; how rewards/equity are given
   - Last year, Larry worked with four managers that closed shop because of compensation problems
2. Describe what you do in simple terms
3. Dual hot role - investment management marketing and investment management

- Consultants like to see a clear delineation between the two roles (having sufficient backup)

4. Credible knowledge of what you do; what your firm does
   - This includes everyone in the firm, e.g., receptionists should be able to explain firm s functions
5. Four P s - philosophy, process, portfolio, performance
   - Fifth — P Pricing
   - Sixth — P Partnering
6. Know consultants other clients (besides the ones to whom you are presenting)
   - If presenting to a foundation, research purpose of foundation and incorporate into your presentation
   - After presenting, or if you win the business, be sure to keep in touch with the Board member who introduced you
7. Keep consultant informed of any firm changes
8. When marketing, if your firm has two stellar products, do not try to include the other products amongst the two stellar products. Consultants feel this is a waste of their time.

Questions/Answers

1. If a firm has $500M - $750M assets under management, you won t make it on a short list. How do we get in front of the right people?
   - Search out consultants who take the time to meet with you
   - Also, introduce yourself to the bigger consultants anyway - remember your assets just may grow enough
2. What is the typical meeting time allotted with an investment manager?
   - Currently one hour, down from an hour and a half
3. What is most useful to cover in that hour?
   - Concise material
   - Four P s ; emphasize performance
   - Professional biographies
   - Follow-up, send any material promised to the consultant in a timely manner
4. How important are RFPs?
   - Dorn, Helliesen & Cottle say RFPs are still important; they advise to complete RFPs more thoroughly. They throw out 15% of the RFPs received due to incompleteness.
   - Clear and concise graphics are an added advantage
5. How important are one-pagers?

- Gray and Company constantly passes on good, informative one-pagers to his clients
- This is a good, competitive way to get your name out there

Manager Evaluation Priorities

More and more managers are finding themselves under a microscope in providing superior returns. What are the key elements for evaluating managers in a very competitive environment?

William G. McVay
Legg Mason Consulting Group

- Consistency. Whether it is the best performance or not, being consistent is seen as favorable.
- Descriptions of people, process, philosophy
- What is Due Diligence business?
  - It is: the consultants agenda
  - It is not: performance; marketing presentation; visiting with regular marketers
  - They do not want a fancy lunch
  - They want to see the portfolio managers and analysts
  - They want to see everything, which could take all day
  - They want to know the qualitative, since they already know the quantitative
- Manager evaluation breakdown:

  Philosophy/Process: *30%*
  What tools help make your decisions?

  Performance: *40%*
  Consistency; overall performance; composite return quality

  General business: *10%*
  Administration/compliance; planning/growth

  Client retention: *10%*

  Personnel retention: *10%*

William Madden, Ph.D., Regional Practice Leader
Towers Perrin

Essential Elements for Evaluation

1. Personnel
   - Manager s client load; what other clients do we have in common?
2. Product/Philosophy

- Do your products fit with the client? Is there a competitive advantage in considering you?
- Portfolio characteristics

3. Client service
   - Frequency and quality of reports; personnel responsibilities; access to other services/information
4. Performance
   - AIMR-compliant
   - Relative to benchmark
   - Up/down market results
5. Business management
   - Firm history; client base
   - Are you profitable? Growth expectations?

Questions/Answers

1. How important is it for a manager to provide all consultant requests (during a due diligence visit)?
   - Consultant feels they deserve to know everything, including: seeing income sheets; employment contracts; etc. They are placing a large amount of money with you and seeing all, knowing all, is part of the package. Consultants want the same for themselves: they provide whatever their clients request.
2. How does a consultant guide clients? What are the current concerns?
   - There is angst about this strong market, and everyone is waiting for a crash
   - Interest in employee protection strategies
   - Lots of hand-holding; counseling
   - Plan sponsors want managers who can manage well in downtimes
   - Plan sponsors are thinking about protection: they have made a lot of money (more than they ever expected), and they want to protect it now. This could be why alternative investments are taking hold.

Saving Accounts

With future performance expected to be moderate, plan sponsors would prefer to retain their managers. How can managers effectively work with consultants to ensure long-term relationships?

Larry Hull, Jr., President
Larco Advisors, Inc.

Investment management is a people business; communication is the key element. Strategies for saving accounts:

1. Listening

- ♦ Are you hearing and thinking about what plan sponsors are saying? What are they really saying?
- ♦ Success comes when you learn to balance how much time you talk with how much time you listen
  - If you listen/think/hear, you will be in alignment with their needs

2. Prepare yourself with the following:
   - ♦ Be humble; talk across to consultants, not up or down
   - ♦ Design your presentation so the consultant asks more questions, in turn, talks more than you do
3. Performance
4. Professionalism
   - ♦ Demonstrate you have highly skilled people in critical positions
5. Succession plan
   - ♦ Does firm have one in place? What is it?
6. Compensation
7. Show how you add value
8. Managing is more artistry than science; don t get bogged down on the technical side
9. Make the consultant look smart

Charles L. Johnston, President & CEO
Johnston, Dragon & Associates

- ♦ This consultant works mostly on retainer fee basis
- ♦ They want to see the best money managers have to offer when meeting with them
- ♦ Work with the consultant as a team
- ♦ Call prior to meetings to discuss the plan sponsor to ensure you give the appropriate presentation
- ♦ Sell your product(s) intrinsically
- ♦ Number one criteria for saving accounts: honesty and integrity in relationships (even if there is a chance you could lose the business)
  - Even when you have done a bad deal, communicate it
- ♦ Client meetings/servicing
  - Do something that will help the client
  - Do not focus on dinners; gifts; etc.
  - Discuss firm changes
- ♦ Describe your process quickly and concisely
- ♦ Put more emphasis on the chemistry between investment managers and consultants

- Charlie disagrees with consistency being of top importance; if a manager is always mediocre, why is that so great? Manager needs to take a chance and shake things up.
- Turn every client into a life annuity

Priority Screening in Reviewing Managers and RFPs

Consultants have so many managers to research that pre-screening managers becomes critical.

Joseph L. Fein, Senior Consultant
Sedgwick Noble Lowndes Asset Consulting

- Screening/reviewing RFPs
  - Asset allocation process is important
  - Explain how you decide weights
  - Consultants want managers to recommend asset allocation
- Defined contribution — when making a decision, they consider:
  - Target market fit
  - Type of technology used
  - Product availability; e.g., small cap products; they are looking for a small cap product and cannot find any because good small cap products grow and change before there is a chance to invest

Luke M. Collins, Director - Investment Consulting Group
KPMG Peat Marwick

- Advice for screening/reviewing of managers
  - Pay attention to the types of products/clients that the consultants have; e.g., do not offer defined contribution information if consultant has no defined contribution clients
  - Send mailings
  - Phone a few times a year
  - Treat consultants like clients
  - Communicate advice - fully disclose changes or problems

Questions/Answers

1. Are you interested in alternative investments?
   - Currently, they are not doing any searches, but want to stay on top of what is going on in the industry

2. How many accounts per portfolio managers are too many?
   - ♦ There is really no set answer; depends on style and size

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New Markets For Managers

There are many new markets with unlimited opportunities for managers with new and existing products. For example, Alternative Investments, which represent everything other than plain vanilla equity and fixed income products, are having a wonderful reception among hospitals, endowments and foundations.

Barry M. Gillman, President
Farris, Gillman & Associates

Japan

- ♦ US-based investment firms selling in Japanese market must:
  - Determine whether their product(s) meet local needs
  - Short-list potential local partners
  - Check appropriate business fit (versus investment philosophy fit)
  - Build relationship Japanese-style (patience)
  - Provide active promotional support
  - Show up frequently
- ♦ Key factors in selection process:
  - Performance
  - Product
  - Differentiated concept
  - Simple explanation of product, but with detailed statistics
  - Promotion
  - Access to distribution relationships
  - Attitude of promoter
  - Aggressiveness of your marketing
- ♦ Products in demand:
  - Quantitative
  - Global or sector equity
  - Yield-enhancing fixed income
- ♦ Go to Japan if you are good, but do it the right way

Martha Spano, Senior Vice President
Callan Associates

- ♦ Industry focus:

- New asset pools
  - Insurance companies
  - Healthcare organizations
    - Wrapped bond portfolios
  - Defined contribution

♦ Product focus:
- Alternative investments
- Real estate
- Opportunistic fixed income

Insurance companies

♦ Insurance company characteristics
- Integrate the investment portfolio into overall corporate objectives
  - Asset/liability position
  - Liquidity requirements
  - Tax requirements
- Need to comply with all relevant insurance regulations
  - Rating agency guidelines
  - Reserve limits and restrictions on asset classes
- Investment managers are often used in a consulting capacity
  - Asset liability modeling
- Key servicing requirements
  - Specialized expertise in insurance fields
  - Tax modeling
  - Customized reporting

♦ What insurance companies look for
- More than a good 5-year track record
- Knowledge of insurance industry issues
- Resources and services beyond investment management
- Cash flows testing and asset liability modeling
- Portfolios customized to insurer s business conditions and cash flows

Healthcare organizations

♦ Size of the market: over $250 billion investable assets

♦ About 55% in corporate (non-ERISA funds)

♦ Three types of funds
- Retirement (DC, DB, Non-qualified, Post-Retirement Medical)
- Operating (Working Capital, Funded Depreciation, Reserves, Self-insured Funds)
- Philanthropic (Foundation, Endowment)

♦ Healthcare trends

- Mergers and consolidations have increased the complexity of financial management
- Need for better structure of investment programs
  - Enhance returns
  - Minimize risk
  - Satisfy liabilities
- Consolidate fund management
- Balance sheet duration management

♦ Why is the new focus on investment earnings?
- Decreased federal funding for Medicare programs
- Investment income offsets revenue short-fall and enhances competitive viability
- De-emphasis on cost-containment
- Increasing focus on value-added benefits and outcomes
- For-profit status vs. non-profit organization

♦ Impact on investment policy
- More aggressive asset allocations
  - Longer time horizons
  - Increase in equities
- New investment classes and vehicles
  - Equities — small cap and international
  - Alternative investments
  - Wrapped products

♦ Evolution of the custom hospital wrapped product
- Competition is eroding price margins on service delivery
- Revenues from the hospitals investment portfolios = subsidies for operations
- Market volatility and market value accounting required by FASB 124 point to more conservative portfolios

♦ What is the custom hospital wrapped product?
- New structure for the fixed income portfolio with two components: fixed income portfolio and the wrapper
- Based on the design of the synthetic GICs
- A fixed income portfolio is wrapped by a contract
- The wrapper amortizes the gains and losses of the fixed income portfolio over the term on the GIC
- Costs: investment management fee of 30 bp plus about 35 bp for wrapper and design

♦ The advantages
- Book-value accounting (account opinion)

- Stabilized returns — wrapper smoothes market and portfolio volatility through annual crediting rate
- Downside protection — crediting rate is never less than 0%
- More aggressive allocation (more equities and higher possible total returns)
- Flexibility and control
  - Select fixed income manager
  - Select wrapper
  - Maintain control of investment policy

Defined contribution plans

- Assets continuously growing
- Estimated 5-year growth projections to be nearly 12.5%
- Investment choices
  - Average number of investment choices is six
  - Fixed income, stable value and money market funds are provided in over 60% of plans
  - Equity assets have increased
- Alternative investments are being considered in all industries
  - Increasing allocations to this asset class
  - Traditional asset classes, equities and bonds, have lower expected future returns
  - Especially hospital funds, foundations, and endowments, which need to increase total returns
- Types of alternative investments
  - Private equity
    - Venture capital, buyouts, restructuring, sub-debt, hybrids
  - Natural resources investments
    - Timber, oil and gas, agriculture
  - Managed futures/commodities
    - Active, passive/long only & long/short
  - Hedge funds and portfolio overlay
    - Macro, long/short, short, event-driven, market-neutral
    - Equity, fixed income, currency
- Trends
  - Plan sponsor use of private equity will continue to increase
  - Venture funds are disbursing capital at record rates
  - Most commitments are toward large cap funds
    - Purchase multiples for companies are increasing
    - Technology and service buyouts should grow
  - Oversight managers are reviewing distressed funds more actively

- International, co-investment and direct investments are hot topics
- Timber is the asset class of second most interest

Real Estate

- Many plan sponsors are at a crossroads with real estate
  - The real estate correction and strong financial markets have moved allocations below target
  - Previous experience with commingled funds is causing hesitation with some plan sponsors
  - This provides an opportunity for plan sponsors who proceed
- Trends
  - A number of plans are looking toward securitization for exit (and investment)
    - Method of investment and impact on (place in) portfolio are key questions
  - Concern about hot REIT market
    - Perceived chance of correction
    - Plans do not want to market time or buy at the top
  - REITs are structured to be either:
    - Operating companies, buying and managing assets
    - Allocators — allocating across capital market paradigm of debt/equity and public/private
  - Opportunistic funds are replacing vulture funds
    - Promised returns of 15% to 20%
    - Leverage is common
    - Deals are difficult, still related to 1980s issues
    - Being in the deal flow is critical
  - Separate accounts are moving toward more manager discretion
    - Greater accountability for the manager
    - Wholly owned assets are gaining in popularity, as more plan sponsors are becoming large enough to pursue such strategies prudently
    - Real estate consultants are pitching oversight manager services
  - Old commingled funds with difficulties are continuing to be worked out
    - Roll-up on funds into a REIT to be taken public
  - Some plan sponsors have packaged existing portfolios and sold them to REITs at mark-ups over book value
    - Takes a large portfolio and staff
    - Having a discretionary manager execute a sale is another option
- Fixed Income

  Callan conducted over 40 searches in fixed income last year:
  - Core 18

- Core Plus 3
- High Yield 3
- International/Global 6
- Other/Specialty 9

Thomas Jones, Jr., President
J&L Investment Consulting Services

- Consultants do not have control over the market; you can go directly to a plan sponsor with a new product
- Create new products for your firm
- New products lead to new markets
- Fidelity is a good example of creating new funds/products
- Internet
  - Get a web site
  - Market through the Internet
  - Actively market your web site through e-mail
  - Put internal research on the Internet
  - Sell it; it s a great commodity
- Marketing to existing clients
  - Ask for referrals from existing clients
  - Suppliers; unions; industry groups; their clients
  - Ask what they will buy
  - Create a plan; include all employees; define goals
  - Research new products and markets
  - Determine distribution channels

Marketing to Consultants

Plan sponsors are seeing fewer managers. Consultants have become the gatekeepers to growing pension assets. How can managers build their firms reputations with consultants?

Mary Ida Compton, Senior Associate
Alan D. Biller Associates

Criteria for money managers

- Communicate through mailings, meetings, phone calls
- Provide market commentaries
- Inform consultants of changes in staff/ownership structure

- Describe how your firm provides good incentives for employees
- Be able to explain and elaborate on investment selection criteria
- Discuss the investment process that is driving the selection
- Bring portfolio manager(s) to finals
- Cover performance allocation/attribution

Terry A. Dennison, Principal
Mercer Investment Consulting, Inc.

- How consultants see the world with investment managers
  - Initial contacts
  - Follow-up/periodic update meetings
  - Finalist presentation
- Consultant environment is driven by demand
  - Projects come up in the middle of very busy times
  - High pressure; high travel; limited attention span and available time
- Client demands
  - Plan sponsors believe they can demand attention from consultants at any time
  - Senior consultants are on call all the time
  - This consultant gives his clients his itinerary on the weekends
- Consultants are seen by their clients as leading-edge experts
  - Consultants have to educate themselves
  - Remember how managers can help the consultant
  - Consultants appreciate any new ideas or information on technology they receive from managers
- Persistence (after no returned phone call) just bugs the consultant
- Every time you pass through town, you do not need to meet with consultants
- At follow-up meetings, do not start from square one and repeat information you provided at the first meeting. Also, do not repeat information that a consultant can get internally.
- Being directed to speak to or meet with a junior staff professional should not be viewed as a negative. Junior staff carries a lot of weight, and their opinions count.
- To-dos for marketing
  - Demonstrate innovative approaches/process during meetings
  - Communicate significant internal changes
  - Share your views on the markets
  - Provide good written material that is informative

- If you describe your process by saying, With our equity product, we use a proprietary screen and then do research. Go on to explain the type of research; what and why; what you are doing with the research?

- Finals presentations
  - Find out the time allotted in advance and stick to it
  - Do not let the marketing person take more than 2% of the time describing the firm
  - Know the plan sponsor s asset mix (it is okay to call the plan sponsor or the consultant prior to the meeting to learn this; it shows you care)

- Preferred style of presentation
  - #1= Performance; fees; style
  - #2= People
  - #3= Firm Logo

General comments from panelists

- E-mail is good
  - Anything you can do to make our job easier is appreciated
  - E-mail performance returns
  - Keep your web site updated
  - Learn which program the consultant uses when e-mailing files
- Focus on risk and risk control management
- Plan sponsors are concerned with protecting assets more than capital appreciation

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Total Resource Vs. Boutique Firms

Plan sponsors are being introduced to one-stop shopping including: investment services; employee life/disability insurance; and consulting and health programs. Can these mega firms secure the best people for all these disciplines?

T. Jon Williams, Ph.D. & CFA, Director
Asset Strategy Consulting

Total Resource Firms

- Today, firms are offering more and more services from analytics to consulting to asset management
- Listing asset management last is not going to intrigue Asset Strategy. They hire specialty firms where asset management is the number one service offered.
- Asset Strategy hires managers for their performance and for them to beat the benchmark

- The trend seems to be more firms are offering many services and often they outsource. The question is, can they do it well?
- State Street, MetLife and Russell are three firms successfully offering many services

Sean Cuminskey, Associate Director
RogersCasey & Associates
Boutique Firms
- Advantages of boutique firms:
  - Service, niche capabilities
  - Successful with specialized products
  - Employees have greater personal exposure
  - Vehicles of innovation
- How to compete
  - Establish thought leadership
    - Emphasize your expertise
    - Accentuate your presence as a unique manager
  - Reasonable succession plan
  - Pay attention to organization/risk management
- What the future holds
  - Boutiques will be here for quite some time
    - Innovation is key
  - Barriers
    - Large firms
    - Life cycle
    - Hard to stay independent

Total Resource Firms
- For DC market, total resource firms have a competitive advantage
- Mutual fund area is growing

Trends
- Increased competition among firms
- Multiple market channels
- Focus is on product, not firm
- Competitive pricing
- Large, multi-product firms:
  - Advantage: Size and resources available
  - Disadvantage: Client service and individual focus decreases

- The more products offered, the more the focus becomes blurred across products

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Differentiating Your Firm in a Competitive Market

With competition among managers for new business accelerating each day, firms need to articulate their strengths clearly. What makes a firm unique in today s marketplace?

Paul Margolis, Managing Director
Effron Enterprises, Inc.

- Performance is important; however, demonstrate that you are doing something that differentiates you
- PSN database
  - Most all consultants use PSN
  - All managers should be in this database
  - Paul suggests you call PSN or visit their offices prior to completing the questionnaire so you do it correctly
- Marketing and selling should not be synonymous
- Driving factor in successful business: 3 to 5 year marketing commitment

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Marketing Active Management

With the markets going through a period of slower growth and uncertain portfolio returns, plan sponsors need to be assured that managers can demonstrate that passively managed funds are not the solution. How can consultants help the manager in this process?

Luke M. Collins, Director - Investment Consulting Group
KPMG Peat Marwick

- There is no winner between active and passive management
  - Explain how active management can work with passive management
- Define your active management
  - Fees
  - Risk adjusted performance
- Enhanced indexes
  - KPMG Peat Marwick is leery of enhanced indexers
  - You are paying a quasi-active fee; do they really know what they are doing?
- Fees

- Over time, if an active manager continues to match or beat the benchmark, fees should be lowered
- Active managers can raise some cash in a down market. Mr. Collins is surprised that more large cap managers have not cut fees.
- Plan sponsors feel when they see the breakdown of fees over time, they are dumb-founded that you (the portfolio manager) are making *so much money*

♦ The future is good/beneficial for active managers; the market will go down, and they will still make money

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Future Marketing: How Evaluation Process is Changing

Consultants are faced with having to provide an array of services to clients in order to remain competitive. There has also been an increased number of new managers entering the business. These developments have created gridlock with many consultants and managers in conducting meetings and reviews.

Natalka Bukalo, President
Chartwell Consulting

1. How can managers get time with consultants?
   - ♦ Keep your firm s information in databases updated and correct
     - Pay attention to how you complete the questionnaires for databases. Often times, N/A or leaving a blank is not perceived well. Plan sponsors ask, how will they (investment manager) treat us if they do not take the time to fill out a database?
   - ♦ Use the Internet
     - Chartwell likes to receive e-mails with Excel spreadsheets attached; or, quarterly newsletters attached in MS Word
   - ♦ Teleconference calls
     - Very valuable tool
     - Face-to-face meetings are not always the only way to get a consultant s time
2. How are quantitative and qualitative criteria manager reviews changing?
   - ♦ Power of technology
     - Consultants are using analytical software. Prior to a meeting, style analysis is being done on investment managers numbers; be ready to discuss style analysis of your products and whether you are benchmarking yourself correctly.
3. How can managers introduce new products?
   - ♦ Explain why you are adding the product

- We see a lot of demand and want the business is not a good answer. Instead, define:
  - Trading differences
  - How you are supporting the new product
  - Demonstrate the commitment your firm is making

4. With manager reviews being compressed, how can the manager enhance their consultant meetings?
   - Same way they get meetings:
     - Update and provide correct information in databases
     - Use the Internet to communicate
     - During meetings, make one or two discussion points; do not cover the firm s entire product line-up
     - Provide compelling reasons why consultants should look to other asset classes
     - Educate

Winning the Finals

Consultants are critical to managers in winning the finals. They are an extension of the plan sponsor. They can assist you in presenting your firm s strengths.

Dale Stevens, Executive Vice President
Wurts, Johnson & Company

- Maximizing your presentation
  - Prepare plenty ahead of time
  - Learn about your prospect
    - Explore your sources of information: company reports; Internet; other professionals servicing the prospect (lawyers; staff; trustees)
- Presentation materials
  - Add value to your script
  - Provide some type of handout to board prior to final
- Presentation mechanics
  - Stick to the time schedule
  - Stick to the script
  - Be careful what you say if you deviate from the script (some managers have been known to insult board members without realizing it)
  - Brief question and answer period
  - Two s company, three s a crowd

    - Bring three participants to a final only when presenting to a large group and if you have over an hour to present
- Provide real-life examples
  - Use examples that relate to the plan sponsor
- Conclusions
  - Simple wrap-up

Jeff Nipp, Senior Consultant
Towers Perrin

- Who
  - Bring the senior portfolio manager
  - Utilize the consultant for board background
  - Practice your presentation, but do not memorize
- What
  - Inform board of firm and personnel background
  - Explain your decision-making process concisely
  - Give two-to-three examples
  - Let them know what they should expect from your client service going forward
  - Identify the value added of each step of your process. This will set you apart from your competitors.
- How
  - Begin and end the presentation with distinguishing points
  - Focus the presentation as a discussion; not a lecture
  - Answer questions concisely
  - Know the portfolio well
- If you do not win the final, call the consultant and ask why. Also, ask why the other manager won.