How strong investment governance frameworks have helped institutional investors navigate the COVID-19 crisis

Key points

- *Institutional investors zeroed in on their liquidity and cash position as the crisis initially peaked across March and April.*
- *Institutional investors increased their internal communication between board, management and investment teams.*

Institutional investors should now reflect on the investment governance lessons they have learned through the pandemic and consider if any improvements should be made.

Institutional investors have increased communication between boards, management and investment committees, as well as bolstering liquidity monitoring, in the wake of the COVID-19 pandemic. The current environment provides a good test of your investment governance framework and how it works in practice, clear delegations and accountability are important; as is the need for regular and effective communication.

Liquidity and valuations in a crisis

Cbus Deputy Chief Investment Officer, Brett Chatfield, said March to April was the peak period when equity markets fell sharply, the $A dropped, and there was elevated member switching, including a "significant flow" of members into the cash option.

"But having said that, we never got anywhere near any level of concern in terms of illiquid assets," he said during a governance session at Frontier's annual conference.

"Throughout the whole period there was, as you can imagine, very close monitoring of liquidity. We had a cash meeting every night – we reviewed the current position – there was a lot of reporting up to the investment committee… the fortnightly meeting to the board covered a lot of liquidity considerations as well."

Chatfield stressed the importance of having a framework in place and being clear where the liquidity is in your portfolio, and ensuring that is in fact providing liquidity when you need it.

The fund was helped by its decision to invest in high-quality, highly liquid cash, rather than enhanced cash, and to focus solely on government and semi-government bonds in its bond portfolio. Meanwhile, it facilitated more frequent valuations of unlisted assets to ensure true and fair value as members were more frequently switching or withdrawing funds.

Sandi Orleow, a Director of Local Government Super and Investment Advisory Board Member of the ACT Treasury, said the market had learnt many lessons about liquidity following the global financial crisis, although record low interest rates now posed another challenge.

"Even in this market, you can have liquidity but I think when cash is giving you so little return or zero return, you've got to worry about the cash drag and earn your money in terms of being effective in how you manage liquidity effectively within the portfolio."

The RBA cut rates to a new record low of 0.25% as the pandemic hit in March but has flagged its reluctance to go further. She said in such a low interest rate environment, combined with volatility and member switching, funds will need to remain focused on liquidity management.

Often there are specific triggers for out-of-cycle valuations within existing policies. "I think valuation of illiquids for member equity will be an issue that the industry as a whole will need to grapple with and funds have a large exposure to that area," she said.

Frontier Advisors Head of Governance Advice, Natasha Kronouer, said it had been advising investors to ensure they have appropriate governance processes in place to move quickly and manage liquidity.

"Can a circular resolution be quickly agreed and acted upon? Is there sufficient flexibility in the governance arrangements to implement decisions quickly given the markets were moving so quickly?"

Frontier also helped its clients by updating its liquidity modelling assumptions and preparing a governance checklist; focusing on liquidity, valuations and governance arrangements.

Reassessing risk appetite

The investment and economic outlook remains volatile given the second COVID-19 wave, highlighting the importance of scenario testing and understanding the impact on liquidity and risk appetite.

"The crisis has highlighted the importance of governance around risk and reassessing your risk appetite," Kronouer said. "There have been so many situations where decisions have been made really quickly and having those open lines of communication between management, investment committees and boards has been a priority."

At the peak of the crisis Cbus held board briefings every two weeks to consider investment member and admin issues.

"Having that significant uplift in communications was very important with the investment committee and the board," Chatfield said.

Orleow said governance frameworks had held up well during the crisis, including having delegations that still ensured clear and accountable decision making.

"I think that investment governance will continue to always change and evolve to the environment that it needs to accommodate or work within," she said. "So, I don't envisage changing – I think it will continue to evolve."

Key questions the panellists answered

- *(4:41m) How did investment governance protocols like delegations evolve during the crisis?*
- *(10:17m) What measures did you put in place to ensure liquidity was managed?*
- *(18.25m) What measures did you put in place to ensure that valuations were appropriate during the market downturn?*
- *(24.27m) Has working remotely created any issues from an investment governance perspective?*
- *(31.05m) Are there any particular investment governance related lessons you've learned or areas that will be a focus for your fund going forward?*