# Fiduciary Management for Defined Benefit Pension Schemes

## What is Fiduciary Management?

Fiduciary Management (also known as "delegated investment" or appointing an "outsourced chief investment officer") is a governance model that enables institutional investors to delegate the more detailed aspects of their decision making to a professional firm. This model is designed to target improved **"financial outcomes"**, better meet the **"time and expertise"** requirements of running a pension scheme and deliver **"value for money"**.

## How does Fiduciary Management work?

The fiduciary management contract gives a professional third party the authority to execute a scheme's strategic investment policy and report to the Trustees. That means the Trustees are able to focus on the strategic issues such as setting the long-term goals for the scheme, whilst the fiduciary manager deals with the complexity of day-to-day investment decisions and operational burdens of managing funds.

## What is the regulatory view on Fiduciary Management?

### *The Pension's Regulator[1]:*

"Fiduciary Management is a form of governance model which involves significant delegation of investment powers to the chosen fiduciary manager. Some schemes delegate the management of all their assets to the fiduciary manager; others delegate a part of their portfolio. As with all governance models, under Fiduciary Management the trustees remain responsible for the stewardship of the scheme, including setting the overall investment strategy.

If you consider this an option for your scheme, you should commit sufficient time and resources to the process of selecting and appointing the fiduciary manager. This includes taking appropriate advice and considering a suitably wide range of potential managers, as for any other investment management appointment."

### *Department of Work and Pensions[2]:*

"Evidence suggests that, on average, small and medium-sized schemes are more likely to fail to meet the governance standards expected by the Pensions Regulator and have higher administrative costs than larger schemes. Partly, this is a result of being unable to benefit from economies of scale. Raising awareness of existing forms of consolidation, as well as facilitating new vehicles to enter the market...could provide new opportunities for employers and schemes to overcome those issues".

### *Competition and Markets Authority[3]:*

"We recognise that firms have a legitimate interest in selling additional services and that none of the evidence above implies that firms are seeking to sell Fiduciary Management services that are against their clients' interests."

[1]The Pensions Regulator, "DB investment governance" guidance, March 2017. www.thepensionsregulator.gov.uk/guidance/db-investment.aspx

[2]Department of Work and Pensions, "Protecting Defined Benefit Pension Schemes", March 2018. https://www.gov.uk/government/publications/protecting-defined-benefit-pension-schemes

[3]Competition and Markets Authority, Provisional Decision Report from review of investment consultancy and fiduciary management industry, July 2018 https://assets.publishing.service.gov.uk/media/5b4f4db2e5274a730e4e273b/investment_consultants_market_investigation_provisional_decision_report.pdf

## Does appointing a fiduciary manager change my duty as Trustee?

Accountability for the investment strategy (overall risk and return) and, ultimately, the security of members' benefits remains with the Trustee board. The fiduciary manager implements the investment strategy within the boundaries set by the Trustees. The Trustees monitor the work done by the fiduciary manager.

The monitoring process is also streamlined, as the fiduciary manager relationship replaces numerous relationships with asset managers and other service providers.

### What is the Trustees' role in a fiduciary model?

Instead of the Trustees making decisions in all of the below areas, under a fiduciary model they are mainly responsible for making strategic decisions and overseeing the execution, with other decisions beneath strategy level delegated to the fiduciary manager:

| Investment process | Decisions | Trustees | Fiduciary manager |
|---|---|---|---|
| **Strategic decisions** | Investment philosophy, overall journey plan and governance model | Decide | Advise |
| **Implementation** | Asset allocation (including dynamic de-risking), hedge design, manager selection and negotiation, implementation, operational aspects | Oversee | Decide |
| **Monitoring** | Monitor performance of various asset managers | Oversee | Decide |
| | Monitor performance of fiduciary manager | Decide | - |

### Are there different levels of delegation in Fiduciary Management?

Delegated investment services are designed to be flexible to a client's governance capabilities and objectives, with variations including:

***How much of the assets to delegate***

Typically a fiduciary manager will take responsibility for the whole of the scheme's assets. In some cases, the fiduciary manager will be responsible for a part of the portfolio, for example all investments within a particular asset class.

***The extent of decision-making authority***

Typically the fiduciary manager will make all of the non-strategic decisions described above. However, some Trustees may continue to make decisions on the allocation to different asset classes, often following consultation with the fiduciary manager.

This model is designed to target improved “**financial outcomes**”, better meet the “**time and expertise**” requirements of running a pension scheme and deliver “**value for money**”.

## Is Fiduciary Management mainly for schemes targeting a high return?

It is true that many schemes have appointed a fiduciary manager to help achieve the return they need to improve their funding position. However, well-funded schemes are increasingly considering a delegated approach to implement a cashflow-matching strategy (often referred to as Cashflow Driven Investment or a Run-Off strategy) whilst they wait for a buyout to become possible.

## Can a fiduciary manager help with sustainable investing?

This will depend to some extent on the fiduciary manager: whether and how sustainable investment is integrated within their investment process, whether their chosen investments meet the sustainability criteria, and the extent to which they can tailor the portfolio to the needs of each client. In particular, sustainability and ESG principles are already part of the core approach/philosophy of some (but not all) fiduciary managers.

## How do fiduciary managers report on scheme performance and how are they held responsible?

A fiduciary manager will provide regular updates to the Trustees on the scheme’s investment performance against the benchmark set by the Trustees. This will typically cover both the performance of the various asset classes and underlying managers. In addition, the fiduciary manager may also report on progress made on the journey to reach secure funding. Additional reporting will cover particular areas of interest, for example the feasibility for a de-risking switch or entering into insurance transactions.

The performance of many fiduciary managers (mainly in relation to the achieved investment returns) are also monitored by third party selection providers.

Certification by The Institute of Chartered Accountants in England and Wales under their Audit and Assurance Faculty scheme can provide further comfort around the adequacy of internal controls.

## Are all fee structures the same?

In the past, fiduciary managers have set out their fees in a variety of ways. However, greater transparency is expected to come in this area, with a move towards more detailed breakdowns of fees and standardisation in how these are disclosed. When considering the level of fees, the Trustees should seek to understand:

- **Different types of fees** – typically these consist of fees for the fiduciary manager, underlying asset managers, and various expenses (such as those for legal and custodial services)
- **Cross charges** – the fees may be paid directly to each party, or re-routed via the fiduciary manager
- **Whether the fiduciary manager can influence their own fees** – for example, by generating good returns (a “performance-related fee”) or via portfolio construction (e.g. by investing in their own funds)

## What are the benefits for scheme sponsors?

The benefits are similar to those for Trustees.
The sponsor gains comfort that the investment strategy is implemented by specialist professionals, in a properly risk-managed manner. This should lead to a more predictable funding (and accounting) position. Contributions are also being used in a more efficient manner, with more certainty over future requirements.

## What are the benefits for pension managers?

Under a fiduciary model, the pensions manager deals with a single party on investment matters instead of liaising with multiple asset managers and other service providers. The pensions manager can also devote more agenda time in Trustee meetings to cover more strategic aspects of running the pension scheme.

## What about conflicts of interest?

Conflicts of interest exist under both a traditional advisory and fiduciary management model, and stem from the commercial incentives for a firm in providing a particular type of service. The main proposal in relation to Fiduciary Management arising from the Competition and Markets Authority’s recent review is to require a competitive tender, to ensure that Trustees have properly considered the merits of different providers before making an appointment.

## Why should all asset owners consider Fiduciary Management?

| | Trustee challenges | Opportunity through delegation | The proof |
|---|---|---|---|
| 1 | **Financial outcomes are uncertain.** Funding levels for many schemes have gone side-ways despite strong returns and substantial contributions. | **Greater control over funding level risk is possible**, with more return for the risk taken. This can lead to steady improvements in benefit security. | Funding levels of our delegated clients[4] improved **3x** that of the average UK pension Scheme[5] with ½ risk |
| 2 | **Investment requires time and expertise.** This leaves insufficient time for strategic items and hinders decision making. | **More time for Trustees to focus on strategic decisions** where they have the edge. Focus on oversight, with execution delegated to professional experts. | Our team consists of: **100+** Operational support; **30** Professional portfolio managers; **Providing trustworthy services** 6th year of AAF 01/06 Assurance[6] |
| 3 | **Value for money from investment service providers requires scale.** Costs, fees and expenses reduce valuable returns by more than is necessary. | **Aggregation creates the scale to drive real value for money.** Scale can also influence product design to ensure clients get a better deal. | **The collective buying power of our delegated clients is larger than the biggest UK pension fund:** **$116.5 billion** Assets under delegation[7]; **100 New products** created for our clients |

[4]Source: Willis Towers Watson. Data as from 2009 to March 2018.
[5]Source: Willis Towers Watson, Pension Protection Fund, The Purple Book (PPF, June 2016) and the Pensions Regulator. Data as at 30 June 2018.
[6]AAF stands for the "Audit and Assurance Facility" of the Institute of Chartered Accountants in England and Wales. AAF 01/06 is an assurance reports on internal controls of service organisations made available to third parties.
[7]Source: Willis Towers Watson, data as at 30 June 2018.



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