

Clearly define roles and responsibilities when a third party handles investment management

Delegated investment management turns over certain functions to a third party, but it isn't a simple outsourcing solution. Rather, it should complement the strategic responsibilities of the plan sponsor.

The model is the same as when a management team acts upon a corporate board's strategy. Clear guidelines are needed to reflect the significant decision making delegated to the investment manager.

The plan sponsor remains in control of high-level strategy, defining the pension plan's long-term funding objectives and determining return requirements relative to the liabilities, while the delegated investment manager implements the daily aspects of that strategy, including portfolio construction and operations.

Figure 1 shows the range of investment decisions and activities, and which function they fall under.

Delegation frees the plan sponsor to devote more time to strategy and, more important, to focus on high-quality oversight.

Typical delegated manager functions

- Allocation to different asset classes, within the plan sponsor's guidelines
- Monitoring the funding level and implementing changes based on market conditions and de-risking triggers
- Hiring and firing investment managers
- Negotiating investment manager fees
- Negotiating legal investment management and related agreements
- Executing documentation
- Managing cash flow
- Monitoring investments at a detailed and higher level
- Liaising with the custodian

We believe the appointment of a delegated investment manager can help increase governance effectiveness if there are up-front, clear guidelines based on the plan sponsor's mission, objectives, and carefully defined roles and responsibilities.

Figure 1. Governing and execution functions

Governing function

- Investment strategy
- Return target
- Risk tolerance
- Strategic triggers

Oversees

Execution function

- Portfolio construction
 - Asset allocation
 - Risk factor exposure
 - Manager selection
- Implementation
 - Portfolio positions
 - Cash-flow management
 - Operation risk management

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