LCP's guide to fiduciary management

Ensuring Trustees get it right first time

**Fiduciary management is one of the newest areas of investment management.
A fiduciary manager takes over not only the management of a scheme's entire asset portfolio, but also makes many decisions previously taken by scheme trustees. That is a huge responsibility and trustees going down this route need to navigate the maze of options available in the marketplace.**

To help you to decide if fiduciary management is right for your pension scheme and how to get the most out of your manager we have outlined the benefits, challenges and key considerations in this independent guide.

Understanding fiduciary management

Fiduciary management has evolved in the UK over the past decade to what we see today. Today, the term fiduciary management is used to describe the delegation of investment decisions, previously taken by trustees, to an appointed fiduciary manager, or provider.

Under fiduciary management mandates, trustees still decide on the overall investment objective (including if relevant a de-risking framework), the rate of return to target and the level of risk that they can tolerate. These decisions cannot be delegated; however under a fiduciary management mandate everything else can – if required – be delegated. This may include strategic asset allocation, liability hedging, fund manager selection/replacement and the overlay of tactical views. In practice there is a spectrum of approaches and the extent of delegation may vary over time.

Some providers may also count partially delegated mandates as fiduciary because they have an element of discretion (for example, an absolute return mandate across asset classes/ managers).

Regardless of the approach used, trustees must retain the responsibility for monitoring the fiduciary manager.

While we believe that fiduciary management can be the right solution for some pension schemes, it does introduce a number of challenges.

Understanding fiduciary management

BENEFITS

Faster decision making

A fiduciary manager has the ability to make fast decisions without waiting for Trustee meetings.

Reduced governance

Typically trustees are less involved in implementing investment strategy so they will spend less time and resources evaluating ideas and managers.

Economies of scale on fund manager fees

The fiduciary manager may pool assets across clients for more favourable fee terms.

CHALLENGES

Conflicts of interest

If fees are based on assets under management a fiduciary manager may not be incentivised to:

- select external funds, even if other managers have more expertise.

- favour lower-fee funds or asset classes (even if these may be more aligned with trustees' overall investment objectives).

- proactively raise de-risking (eg buy-in) opportunities.

Unproven performance

As fiduciary management is a relatively new concept some firms have little hands-on experience. There is also a risk of manager concentration if in-house funds are used.

Higher fees

Fees are higher than the advisory model due to complexity, fee layering and increased reliance on active management.

More complexity

Fiduciary management mandates are complex to set up and even more complex to unwind. It may be difficult to replace managers and transfer assets to insurers in the case of buy-in or buy-out transactions.

Lack of independent oversight

The following diagrams show the governance models that some pension schemes have put in place, highlighting the clear conflict if the person advising on the fiduciary solution is part of an organisation which also offers these services.

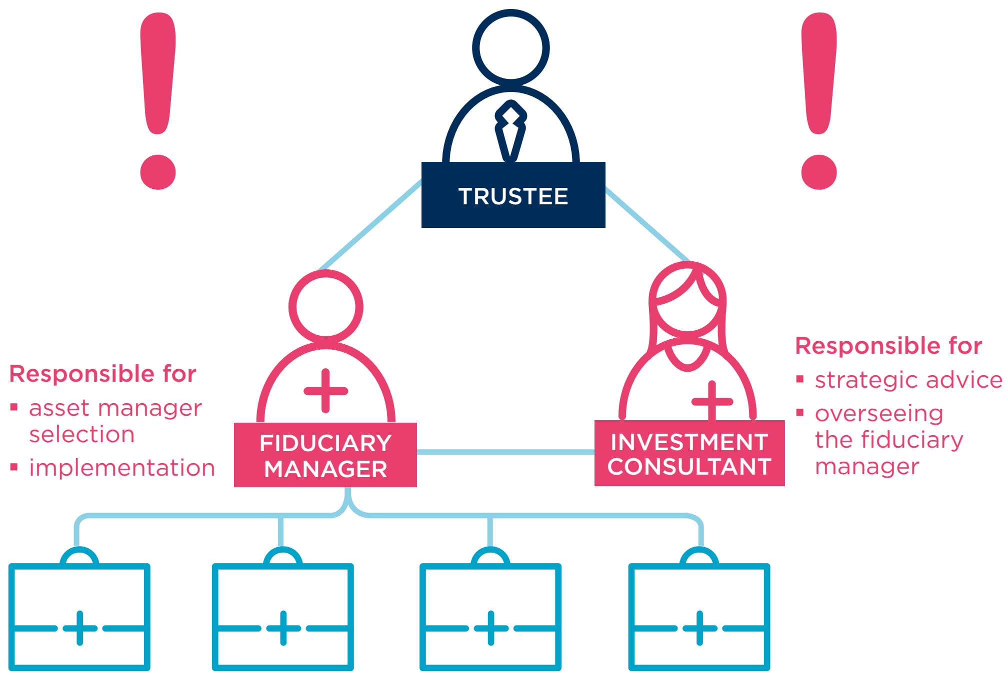
*Fiduciary management with **no** independent advice*

Trustees delegate authority to a fiduciary manager to set the asset allocation benchmark and select and appoint asset managers. But who is monitoring the fiduciary manager?

In brief Simplified information flow but little visibility on manager activity.

*Fiduciary management **from your** investment consultant*

Trustees use the fiduciary management "arm" of their investment consultant firm.



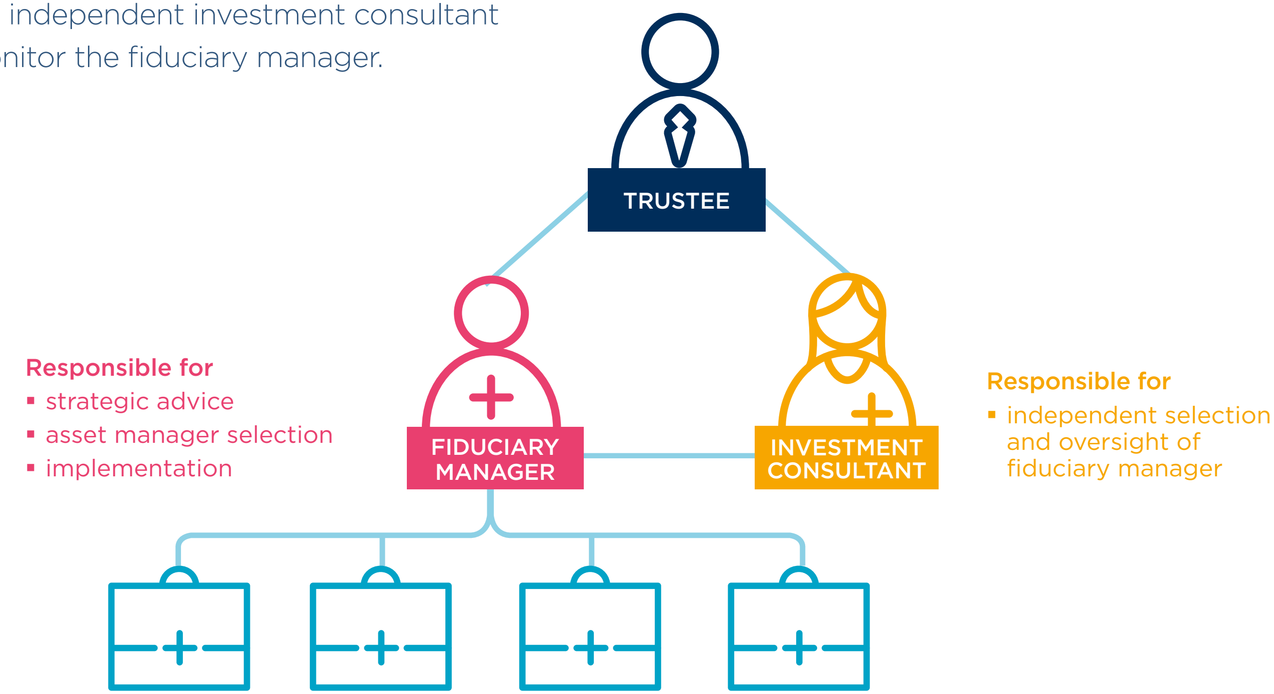
In brief Conflict of interest occurs when oversight is not independent.

Introducing independent oversight

In our experience, having the right governance framework in place can equip trustees to get the best out of their fiduciary manager. In particular, an independent investment consultant can provide objective ongoing monitoring of the fiduciary manager, allowing trustees to have confidence in their arrangements.

*Fiduciary management **with** independent advice*

Trustees appoint independent investment consultant to select and monitor the fiduciary manager.



In brief Consultants are partners, and provide oversight of fiduciary managers.

How can an independent investment consultant add value?

1. Setting the right governance framework

The choice of fiduciary manager is one of the most important decisions for any Trustee. It can be costly and challenging to set up and even more so to unwind the often complex investments. An independent consultant can assist with establishing a suitable governance structure and setting the mandate objectives.

2. Selecting the best provider

A selection process should be robust and transparent, allowing trustees to consider a range of approaches and providers. Trustees should be extremely wary of signing up to a delegated arrangement offered by an existing investment consultant, without being fully informed of all the alternative options.

How can an independent investment consultant add value?

3. Negotiating terms

There are a number of important factors to consider when appointing a fiduciary manager. Schemes need to set high-level objectives, risk tolerances and benchmarks for fiduciary managers. Costs need to be transparent and any performance-related fees should be carefully structured and aligned with a scheme's ultimate objectives, so that they do not incentivise excessive risk-taking. Overall investment management fees can rack up quickly without careful consideration of the underlying complexity, fee-layering and increased reliance on active management.

4. Evolving the investment strategy

Trustees should take a step back and ask whether the scheme's portfolio is suitable for their de-risking journey over the coming years. Who is proactively monitoring and raising de-risking opportunities, such as funding triggers, buy-ins and buy-out? Increasingly, trustees are recognising that long-term investment strategy and de-risking may contain further conflicts for their fiduciary manager.

5. Evaluating performance

As with any investment arrangement, trustees need to fully understand their fiduciary manager's investment process and be able to assess performance objectively. However, due to the complex and unique nature of many fiduciary mandates, it can be hard to compare apples with apples and evaluate a manager's success relative to its peers. An increasing number of trustees are choosing to use an independent investment consultant to monitor their arrangements effectively and provide ongoing challenge to the fiduciary manager.

Why LCP?

To help with this process, trustees need a firm that:

- can set a tailored investment strategy;
- knows the fiduciary market well; but
- is independent from all the participants in the fiduciary market.

At LCP, our day job is setting strategy, and fiduciary manager research is well resourced and fully integrated into our manager research programme. This is why trustees are increasingly turning to us for this vital role.

We do not provide fiduciary management and as an independent firm have seen an increasing number of requests to help clients with their fiduciary management arrangements. We provide these services to clients with all the major fiduciary managers.

We have a central fiduciary manager review team, of which James, Emma, Joel and Rob are senior members, to meet this demand for our independent expertise.

As a strategic advisor, we can offer an independent, fully integrated service, supporting you in setting your overall long-term investment strategy, through de-risking steps and all the way to buy-in or buy-out when the time is right.

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At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy and financial wellbeing.

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