Fiduciary management - Pariah or Panacea?

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Pension scheme trustees are faced with ever increasing complexity, ever sharpening focus and no corresponding increase in time available. So when an organisation offers to relieve them of the investment burden they could be forgiven for snapping up the offer. However, a number of questions immediately arise – how much can they delegate? How much can they trust? Is this approach really new, or just a rehash of approaches which have failed in the past? Is the Fiduciary Manager to be shunned like a snake oil salesman or welcomed with open arms as the answer to all the trustee board's problems? The answer lies somewhere between the two extremes – but first we need to understand what we mean by Fiduciary Management.

Fiduciary Management (or FM) is a term inherited from the Netherlands where the approach originated and is a little misleading. It does not mean that the trustees can escape their fiduciary responsibilities but it does mean that they can delegate the implementation of those responsibilities. This implies ongoing oversight and governance, an issue to which we return later. The Dutch model is one in which an organisation (typically an existing industry scheme in the Dutch context) takes responsibility for managing the whole of the assets of a scheme with regard to the liability position. To complicate life, in the UK the term is often also used for a range of other approaches, including:

- delegation of a slice of the assets
- delegation of the assets without reference to the liabilities
- implementation of consulting advice
- asset allocation services

This is partly because organisations seeking business in this space can often end up with more limited appointments and partly because schemes looking to take advantage of the new broad services available will compare FM with implemented consulting and other approaches. In the final analysis, it is the practicalities which matter rather than the labelling, so let's look at what FM is, and what it isn't.

What Fiduciary Management is not

Accusations fly around. Misunderstandings abound. Is there any truth in these assertions?

'It's just Balanced Management in disguise' – not really. Balanced managers paid attention to the asset side of the equation only, had a much narrower range of asset classes and approaches to use, and offered a non client specific, 'one size fits all' product. And with the exception of a couple of Managers of Managers, they also used entirely in house products.

'It's just a way for asset managers to sell product' – done properly, FM should involve external management of the various asset classes. Too many conflicts arise when internal product is used. Exceptions can be made to this rule – perhaps for passive management for example – but the trustees need to know and be very comfortable before going ahead

'It's just a way for consultants to get paid more for doing the same as they've always done'– implemented consulting should align interests rather than simply making consulting businesses more profitable. The danger is that consulting groups offer a range of approaches and the trustees need to be sure which approach they are buying, that they are paying the right fees for that approach and that they are using the skill of their advisors appropriately. Another reason to get the in house governance structure right.

'FM can be used for a single asset class'– If there is only one asset class, it's not an FM appointment, it's manager of managers.

'It gets the trustees off the hook and means there is no need for robust governance structures in house' – Quite the contrary. FM is a tool for the trustees and can be a useful one but it needs controlling, monitoring and reviewing. A lot of trust is being placed in a single organisation. A lot of focus on monitoring that organisation is also needed. This means a robust investment committee, or a Chief Investment Officer, or an external governance specialist or some combination of these.

A useful approach?

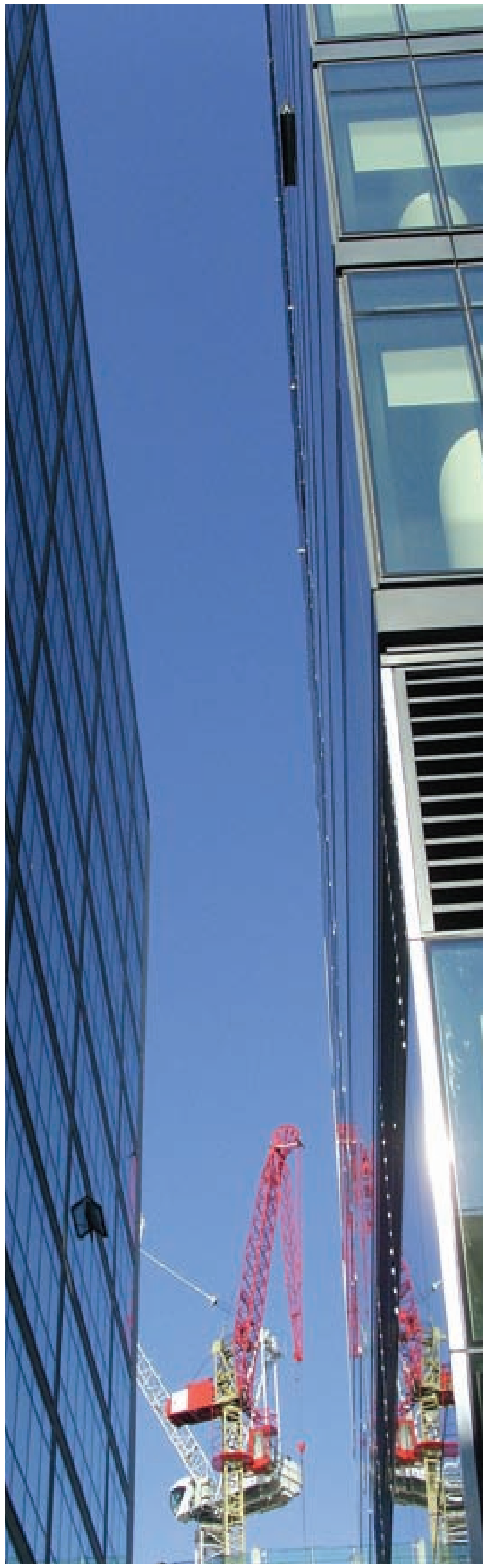
So, if the trustees still need governance structures, is there any point in using FM? There are a number of key advantages which make FM an attractive option but it should be remembered that it is not the only option. The attractions include:

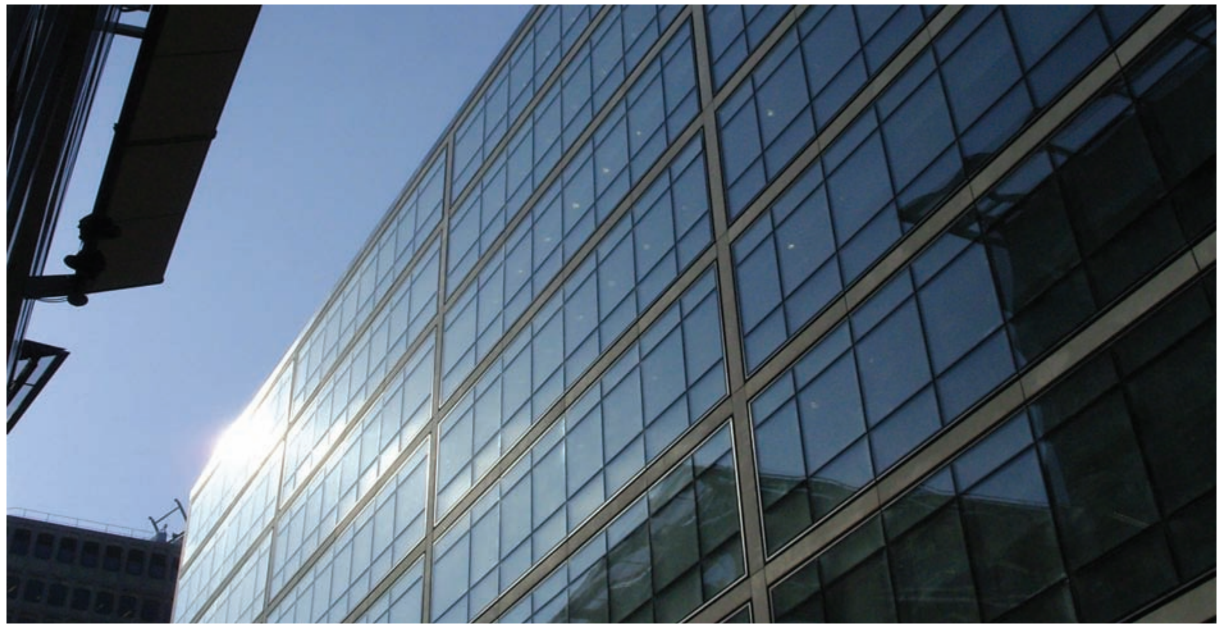
Implementation and execution

The trustee system relies on the commitment of a group of people who spend most of their time focussed on other things, who meet infrequently, and whose primary areas of expertise are neither investment nor pensions. Trustees have executive responsibilities but are essentially non executives by nature. This makes decision making challenging but possible, given focus, training, assistance and advice. It makes execution more than challenging. FM provides a framework and a mechanism for execution. The Fiduciary Manager will agree parameters with the trustees and be able to act within them between meetings and will implement the strategy agreed by the trustees.

Expertise

A good fiduciary manager will bring a wide range of expertise to the table in a coordinated way, will use this to further the agenda and plan agreed by the trustees and will make a significant contribution to an informed debate in agreeing the strategy and plan.





Control

With the fiduciary manager on board, and the right internal structures, the trustees should have more control over the future health of the scheme

Focus

If the fiduciary manager is taking care of the day to day concerns, the trustees are more able to focus on strategy, on covenant and on business planning - a better use of the scarce resource which is trustees' time.

Solvency

With an active executive structure such as a fiduciary manager, managing the asset/liability profile becomes a more realistic option. Some would argue this is the key advantage of the approach.

There are naturally some counter arguments which include:

Control (again)

Does the appointment of a fiduciary manager mean the trustees lose control? The answer to this concern lies in the selection of the manager, the agreement on how the relationship will work and the internal governance structure. In other words, this could be a danger but not if the arrangement is set up properly.

Concentration

If one organisation is used to manage the overall investments there can be concerns about concentration risk. This concern can be allayed by ensuring that the fiduciary manager has good processes (initially and ongoing), appropriate levels of delegation and outsourcing, and high levels of expertise. Choosing and monitoring the manager are important activities.

Selection

There are a number of organisations offering FM, or implemented consulting, or some variation thereon. The approaches differ, the backgrounds differ. The language can be misleading, the differences confusing. Is there a danger of making the wrong decision with disastrous consequences? An ever present danger in all investment activity but one which can be controlled with the right processes.

None of these objections are show stoppers. They might mean that some boards of trustees decide, on balance, not to pursue this option. However, the objections can all be overcome if FM is approached properly. What do we mean by that?

Using FM effectively

If FM is to be used effectively and is to deliver its promise, which includes increasing the comfort and confidence levels of the trustees, then a number of elements need to be present. First of all, and crucially, the trustees need to be in control of the agenda and set the plan. This is their responsibility and cannot be ducked. The fiduciary manager can help and advise but the trustees remain in control.

First the fiduciary manager needs to be appointed and help may be needed with the selection process. This can pose a conundrum since the existing advisors may be conflicted and the potential fiduciary mangers at this stage are certainly conflicted. The answer is to use a third party who is not in the market to provide FM or FM competitor services – governance specialists can help here, also independent trustees and some consultants.

The selection having been made, agreement needs to be reached on the terms of reference. The trustees will be appointing the manager to implement the strategy and this will involve some delegated decision making. It is important to define the extent of this delegation and also the contact point for referral and discussion in between meetings. Clear lines of communication are essential.

The trustees need to have a robust governance structure. The fiduciary manager is being appointed to provide a well coordinated, holistic approach from which the scheme will benefit but this does mean a lot of reliance is placed on one organisation and this implies ongoing monitoring of processes and capabilities. Specifically this will include:

- Adequacy of provider's due diligence
- Breadth and quality of research
- Efficiency of process to turn research into decisions
- Adequacy of resourcing
- Staff retention and motivation
- Ongoing intellectual rigour of the offering
- Transparency
- Internal accountability
- Validation of statements/assertions made by the provider
- Management of conflicts

Our view is that an external third party will be needed for this by all but the largest schemes. That third party should be a disinterested consultant (i.e. one not offering implemented consulting) or a governance specialist or independent trustee. The third party can also help with a number of other issues such as interpreting reporting and other communications, interpreting outcomes, and ensuring that due attention is paid to client specifics in recommending a solution (and changes to that solution).

So, panacea or pariah?

The big challenges facing trustees include increasing complexity, speed of change, and effective execution. Trustees face these challenges across the board, not just in the investment arena so the role is becoming ever more onerous. These are challenges for which the trustee structure is inadequate – unreasonable demands are effectively placed on groups of people for whom this is a part time and occasional activity. Non executives in practice, executive in terms of responsibility. There are a number of potential solutions or partial solutions to this problem – hiring a Chief Investment Officer, (CIO), setting up a committee structure and freeing up more time, asking advisors to take on more responsibility. FM is both one of a range of solutions and an implementation tool available for use by the CIO or the sub committee.

Some boards of trustees will find this level of delegation daunting; to others it will feel like a good fit. Used without proper preparation and structures it is dangerous. Properly used, with appropriate governance structures, an agreed strategy, and adequate monitoring, it is an approach which has the potential to make a significant positive contribution to the management of a pension scheme.

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