Introduction to fiduciary management

Russell Investments

What is fiduciary management and why now?

In the last twenty years, financial markets have become more complex, as investors needed better solutions to address their challenges. For example, liability driven investment (LDI) is technically complex, but has enabled pension schemes to mitigate the risks that soaring liability values pose to their funding levels.

The additional complexity of these solutions places a heavier burden on trustee boards. Some boards, who have proactive advisors and significant investment expertise in-house, can embrace this complexity and make it work for the pension scheme. Others, who do not have internal resources, usually seek to 'insource' the required specialist investment expertise.

This decision is at the heart of fiduciary management: it is about finding the right balance between keeping all decisions with the trustee board, versus delegating some of the day-to-day implementation to an external party. You as trustees are in full control of where you decide to be on this spectrum of delegation.

What would stay the same?

Some aspects of how you currently work will stay the same when moving from advisory to fiduciary management:

The trustees will retain all key decisions, such as the recovery plan, the target level of hedging, and the required return on growth assets. Decisions such as these cannot and should not be delegated.

You will still need good advice. At the heart of a fiduciary management offering is the ability to provide clear and proactive advice. The fiduciary manager still needs to sign section 36 letters, help the trustees draft the statement of investment policies, and work with the Actuary and the Sponsor.

If you wish to retain your current adviser, the fiduciary manager should be flexible enough to accommodate that preference. Your adviser would continue to help you set the high-level strategy, with the fiduciary manager then taking full accountability for implementing that strategy.

What improvements can you expect?

There are a number of benefits that pensions schemes experience under fiduciary management:

Enhanced control. With the additional resource, your fiduciary manager will be able to be more 'hands on' with your investments:

- Your strategy will evolve more often rather than once every three years. It will be continuously evaluated and adapted to take into account forward-looking market views.
- The fiduciary manager will evaluate, appoint, monitor and terminate managers on your behalf, as well as propose new investment strategies.
- They will also monitor your funding level daily. When your funding level improves, they will look to capture those gains by making required trades on the same day. This approach gives you more certainty on your journey to self-sufficiency or buy-out.
- Your specific ESG objectives can be effectively integrated into your portfolio through manager research and voting and engagement, helping you stay compliant with regulatory requirements.

Certainty of fees. Under the advisory model, there is usually a base fee agreed up front. However, any additional work can be charged as a project fee. This sometimes precludes schemes asking the adviser for additional work or for attending meetings to discuss important matters.

Under fiduciary management, there are no surprises – for an agreed fee, the fiduciary manager will attend trustee meetings, provide trustee training, conduct strategic reviews, adjust liabilities regularly for any transfers, and will proactively bring you the latest investment ideas.

Purchasing power. Your fiduciary manager will be able to negotiate access to asset management services at considerably lower fees than an individual scheme, often resulting in lower total fees paid by the scheme when moving to fiduciary management. Any further cost savings achieved through negotiation of manager fees should be passed onto you.

Better alignment of interests. The main difference with the advisory model is that the fiduciary management provider takes responsibility for the overall outcome. Since they are responsible for the day-to-day implementation of the strategy, they will stand behind and be accountable for the results they've achieved. The fiduciary manager should be replaced if they don't perform as well as expected.

Improved transparency and reporting. Most fiduciary managers will have proprietary tools and systems they will use to manage your portfolio every day. As a result, you should expect much more transparency, down to every security you hold.

With better availability of data, you should expect to see more informative reporting; not necessarily longer reports, but more relevant data that the trustee board can understand and act upon if necessary. You have the option of having this reporting customised to suit your exact requirements and preferred method of communication.

Watch David Morton,
Associate Director, UK Fiduciary Management
explain what this can mean for your scheme

What to look out for

As you embark on the selection process, you should test the following aspects of each candidate's service to confirm they are the right firm to be your partner:

Ability to listen first.

Fiduciary management is not a one size fits all product, but a solution that should be tailored to your needs. One option to test providers' ability to listen is to hold a call/meeting as part of the selection process, allowing each firm to ask questions about your unique circumstances. The trustees should check if this discussion is later reflected in the written proposal.

Ability to communicate clearly.

This will be reflected in how your fiduciary provider writes and speaks. Most trustee boards want clear and concise reports that enable them to make decisions. Apart from reviewing each provider's proposal, you might consider asking the top three candidates to deliver a 'mock' trustee training session as part of their finals presentation. This will give you a good chance to see them in action.

Investment expertise and experience.

You should check if providers have been managing money for long enough as a fiduciary manager, and how much risk they have been taking with clients' investments. There are many inter-linked elements of your portfolio. A provider without the systems and experience of managing pension scheme assets can easily miss an important connection, resulting in errors and lost value.

Summary

Under the advisory model, there is a danger that delays in implementing your decisions can adversely affect your journey to full funding. This could be caused by missed opportunities, but also from inability to fully understand and manage risk at a total portfolio level. Adopting fiduciary management can help you to improve governance, enhance control of your investments, gain transparency and certainty of fees, and get more detailed and informative reporting at the total portfolio level. All of these elements should come together to form a trusted partnership with the right provider.

For more information

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