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Perspective

Fiduciary Management

Exploring the 3 C's

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There are several common misconceptions surrounding fiduciary management, typically arising from worries about complexity, cost and lack of control. These three areas should certainly be weighed up carefully when considering fiduciary management, although in reality the arrangement does not need to be complex, costly or require the trustees to give up control.

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Complexity

As the Pensions Regulator has pointed out, the investment industry for pensions continues to develop and innovate[1]. The options open to trustees have multiplied as a result. These include LDI and cashflow driven investment, diversified multi-asset portfolios, illiquid assets, private markets and advanced beta, to name but a few. However, getting the best from them requires significant time and resources. Often, trustees have neither to spare. Fiduciary management provides an investment solution to this issue.

Some trustees may be concerned that the overall investment portfolio could become more complicated in a fiduciary arrangement. In fact, many fiduciary managers adopt a 'manager of managers' approach. This means that, while trustees are likely to have an investment strategy with a wider range of underlying mandates than they are used to, the funds are all held on a single platform. As a result, in many cases governance and reporting arrangements are actually simplified.

1 http://www.thepensionsregulator.gov.uk/docs/db-annual-funding-statement-2017.pdf

Even when fiduciary managers do not adopt such an approach, they are likely to invest in a more diverse range of asset classes, and use more sophisticated investment strategies. Although in some respects this can be viewed as adding complexity, it means that trustees are able to benefit from investment strategies that might not otherwise be available to them.

Overall, fiduciary management aims to ease the burden on trustees, particularly where small pension schemes are involved and investment governance budgets may be limited.

Investment training is a crucial part of any trustee-fiduciary manager relationship. Before implementing new investment strategies, fiduciary managers typically give extensive training to trustees to ensure they are comfortable with any changes being made. For example, using derivatives within an investment strategy to protect against equity market downturns may be viewed as additional complexity. However, with the appropriate level of training, actually implementing such strategies using a fiduciary manager can significantly reduce the risk that the pension scheme is running.

Figure 1: Typical costs

Type of fee	What is this fee?	Is it charged under the fiduciary management model?	Is it charged under the 'traditional' model?
Investment manager fees	Fee on the underlying funds in the investment strategy	Yes, typically charged on an 'assets under management' basis	Yes, typically charged on an 'assets under management' basis
Fiduciary management fees	Depends on the provider and should clarify at the outset. Typically includes: – Investment advice around strategy – Funding level monitoring and de-risking – Reporting	Yes, typically charged as a bundled fee on an 'assets under management' basis	No, typically investment consultancy costs (which cover similar aspects) are charged on a 'time-cost' or 'fixed fee' project by project basis
Performance fees	A performance fee which is aligned to the funding level outcome	Depends on provider	No
Custody fees	A fee paid to a custodian to take on independent oversight and safekeeping of client assets	Some fiduciary arrangements require clients to appoint a custodian on an individual client by client basis, in which case this fee applies. However, typically the appropriate fee would be paid directly to the custodian.	Some 'traditional' arrangements require clients to appoint a custodian on an individual client by client basis, in which case this fee applies. However, typically the appropriate fee would be paid directly to the custodian.
Exit charges	Some providers have a 'lock-in' period where a scheme will be charged on leaving the arrangement in this period	It depends. Many providers do not have a 'lock-in' period	No

Source: Schroders

Schroders

Cost

There is a common perception that fiduciary management is more expensive than traditional arrangements. In reality, there are many 'flavours' of fiduciary management that can be accessed at varying levels of cost.

Although they may not necessarily be more expensive than traditional arrangements, fee structures can be complex. This is particularly the case in 'manager of managers' approaches, where layers of fees are sometimes evident. But, taken in the round, such arrangements may mean that pension schemes are able to benefit from economies of scale in a way they could not were they to be acting on their own.

It is therefore vital for trustees to be clear on the fees involved in a fiduciary mandate. The costs involved depend on the particular type of fiduciary management, but typical costs are set out in figure 1.

One of the easiest ways for trustees to consistently compare costs across different fiduciary managers (or against traditional arrangements) is to consider the 'pounds and pence' total costs. Often different fee components are expressed differently: some are expressed as a percentage of assets (e.g. an equity fund charges 0.45% on assets invested in that fund), others are expressed as a fixed monetary cost for a particular project (e.g. the cost of carrying out a manager selection exercise for a pension scheme is £15,000). Only by summing each of these components in 'pounds and pence' can a consistent comparison be made.

Control

Perhaps the most common misconception about fiduciary management is the fear among trustees that it involves surrendering control of all of their pension scheme's investments. Certainly, by delegating more decisions to the fiduciary manager, it could seem like the trustees' involvement in the pension scheme is lessened. In practice, trustees and their fiduciary manager continue to engage with each other on a regular basis – this is not a 'set and forget' arrangement. Although fiduciary arrangements mean the trustees are not involved in day-to-day investment decision-making, they still retain control over the pension scheme's overall objectives and high-level decision-making. In undertaking these duties, some trustees may choose to be in frequent contact with the fiduciary manager, while others may retain the same quarterly or annual meeting cycle that they adopted under the traditional approach. It is true that, under the traditional model, a significant amount of time is often spent on decisions relating to which investment manager to appoint for a particular asset class. While this is an important decision, research has shown that manager selection only accounts for around 10% of the risk and return of the portfolio, with high-level asset allocation accounting for the remaining 90%.[2] Under fiduciary arrangements, the largest proportion of a trustee's time and attention can be focused on the 90%, rather than the 10%.

A fiduciary management arrangement works well for many trustees who have full-time jobs, as it releases them to spend the limited time they have available on high-level issues, while knowing that their pension scheme's investments are being monitored daily by an investment professional. It means that trustees are able to 'see the wood for the trees', and can focus their time on the most important matter of ensuring the pension scheme remains in line to meet its long-term funding objectives.

Key takeaways

- Fiduciary management need not increase complexity – trustees may access a broader range of solutions
- Trustees must be clear about what a provider's fiduciary fee covers
- Trustees retain control of the pension scheme's high level objectives

2 Gary P. Brinson, L. Randolph Hood, Gilbert L. Beebower, 'Determinants of Portfolio Performance'.

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