

# Pulling the strings



In theory, outsourcing investment decision-making should be a boon to small schemes. Trustees need to make sure they are getting a good service, finds **Kalpana Fitzpatrick**

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**F**iduciary management – outsourcing investment decision-making – has been around in the UK for some years now, but it’s been slow to pick up. It offers the potential to outsource day-to-day investment decisions to a third party, but in doing so poses a dilemma for trustees who have to balance their fiduciary duties with the growing pressure to become more nimble in the face of greater market uncertainty. And as fiduciary management does begin to gain traction in the UK, trustees of smaller pension schemes are having to question whether such an approach suits their needs, particularly as they are restricted by lower governance budgets and fewer resources than their larger peers.

Some argue that fiduciary management is suitable for schemes of all sizes. In particular, small pension schemes can see cost reductions as well as gain access to investment funds and strategies that would otherwise be closed to them. Fiduciary managers are also starting to recognise the needs of smaller pension funds with assets of £100m or less, and many are looking to design solutions for trustees in this bracket.

## BENEFITING FROM SCALE

One of the biggest advantages of using a fiduciary manager is the benefit of scale. Small schemes are often restricted in terms of the universe of investment opportunities they can access, and especially lack the necessary critical mass when it comes to looking at new investment outside traditional equity and bond markets.

Ashish Kapur, head of European institutions within SEI’s institutional group, which has recently taken on the role of fiduciary manager for a number of small UK pension funds, explains: “If you’re a small scheme and want to invest in five different assets, managers of some asset classes may not take you on for such a small amount of money. As a result, a lot of small schemes are left with just equities and bonds.

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► negotiation. We set up and outsource funds to various managers, so the size of the client does not matter. As a result, we are open to clients of all sizes.”

Richard Dowell, head of client management at Cardano UK, says: “Historically, small schemes have not had access to sophisticated liability hedging strategies, good levels of diversification, alternative assets and so on. The right fiduciary manager can provide pension schemes with access to all these strategies.”

The benefit of scale a fiduciary manager brings is a major plus point, but there other advantages that trustees should consider. Key amongst those is the ability to benefit from faster decision-making around investments, enabling schemes to take advantage of opportunities in the markets. Depending on the agreement in place with the fiduciary manager, schemes might also get help with their statement of investment principles, trustee education and access to investment experts.

## LOSING CONTROL

The biggest concern for trustees when considering fiduciary management is the danger of handing over too much control and decision-making power. The term ‘fiduciary management’ is in itself misleading, since it does not take away any fiduciary responsibilities from the trustees. It is better described as the outsourcing of investment decisions, where trustees take ultimate responsibility for those decisions by ensuring there is an appropriate discretionary framework in place. However, even when fiduciary management is understood in this way, many trustees are likely to have major reservations.

Shamindra Perara, head of fiduciary management at Russell Investments, explains: “The levels of delegation can

vary from one client to another and it is the trustees that set the guidelines. The notion that you lose control is misplaced.”

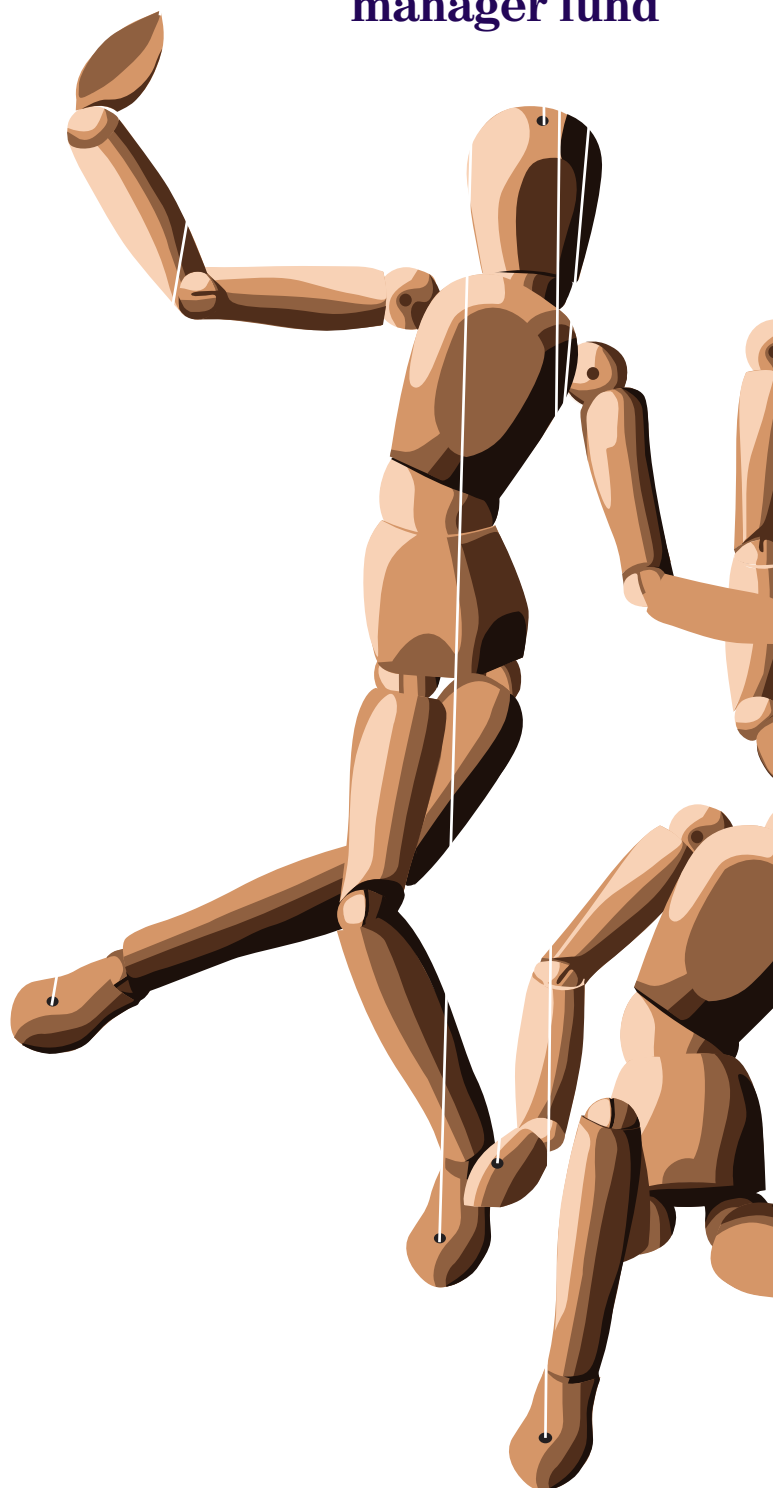
But, with significantly fewer assets under management, trustees of smaller schemes have every right to fear that they could find themselves seeing less in the way of engagement and alignment with their managers. “Less engagement for smaller schemes is always a risk with very large firms who have very large client bases and this should be taken into account as part of the selection process,” explains Dowell.

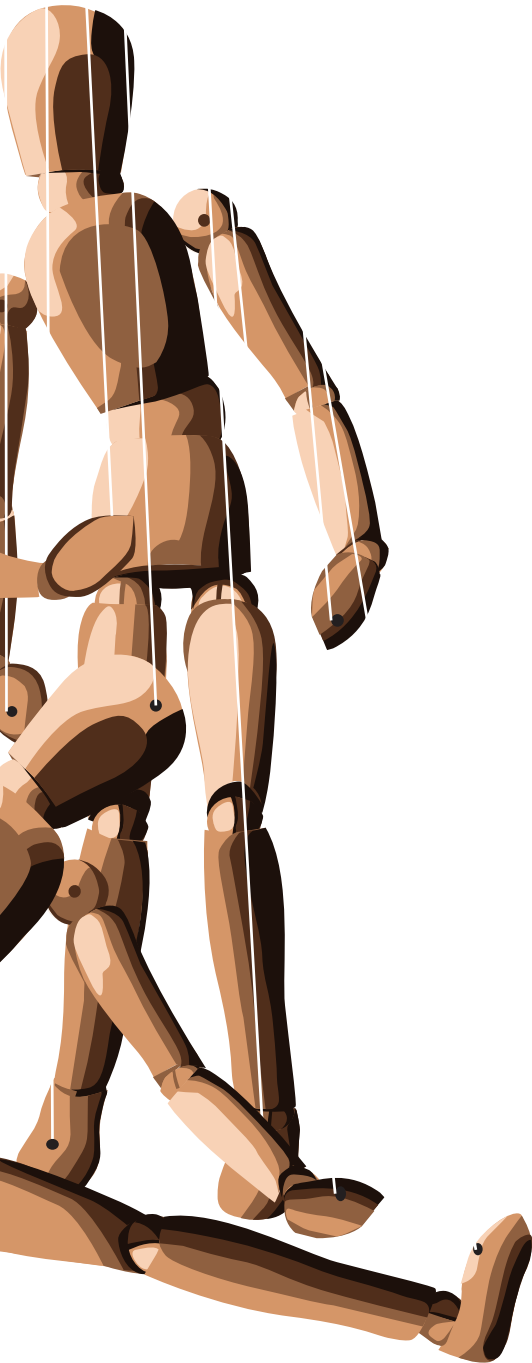
Muse Advisory’s director, Mark Hodgkinson, adds that trustees of smaller schemes should look for managers whose business model allows them to work effectively with their particular size of fund and are willing to allocate appropriate resources to them.

In selecting a fiduciary manager it’s essential to have a clear picture of what is really being delivered. Ideally, fiduciary management or implemented consulting will include practices such as actuarial modelling as a part of the deal, to ensure that the investment strategy matches the individual fund’s needs in addition to managing the assets on a day-to-day basis. However, there is a risk with some providers that what is being described as ‘fiduciary management’ is in practice little more than a multi-manager fund.

Delivering extras such as actuarial modelling is costly and some providers may be tempted to leave such features out of the package for smaller schemes. But those are at the heart of what makes fiduciary management effective. “When done well, fiduciary management should be plugging gaps that the trustees are unable to fill – such as ensuring that they take advantage of de-risking and market opportunities as they happen,” says

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Steve Delo, chief executive of Pan Governance. “But trustees need to make sure that this is really being done by their fiduciary manager.”

Delo adds that, while fiduciary management might reduce the time trustees spend on investment governance, “the structure still needs a lot of governance and oversight,” to ensure that the manager is performing effectively.

### CONSULTANT OR FIDUCIARY MANAGER?

Pension scheme investment consultants have also begun to make inroads into the area of fiduciary management, although they rarely call it by the same name. Implemented consulting or delegated consulting is a comparable offering in that it allows a pension fund to outsource its day-to-day investment decision-making, but consultants are coming from a different direction to fiduciary managers with pure asset management backgrounds.

Russell’s Perara says that although some trustees may find an arrangement whereby their investment adviser offers them a more implemented solution helpful, it is “important that pension funds don’t sleepwalk into such arrangements” and that skills, culture, scale and the ability to perform should be evaluated and compared to an actual fiduciary manager. “Savvy trustees will recognise the conflicts of interests,” he adds.

Jarrod Parker, employee benefits director at consultant Alexander Forbes, which offers implemented consulting services, says that trustee education is essential in understanding the benefits of implemented consulting – and also in thinking through the potential conflicts of interest inherent in having a single company giving trustees advice on investments and then also implementing that advice.

## HABITAT PENSION SCHEME

The £28m UK Habitat pension fund was one of the first small schemes to go down the fiduciary management route and appointed SEI in 2009.

Since then the scheme has reported a reduction in costs as well as an improvement in its funding level: it claims it is now paying around 25% less in fees and has a greater diversification of investments than it had prior to appointing a fiduciary manager.

Malcolm Curzon, chairman of trustees at the scheme, says the move has been cost-effective and scheme trustees still set the investment strategy and have a final say on all investment matters.

The move has left trustees with more time to focus on core strategic issues going forward.



“I think there is no conflict at all, providing that the implemented consultant has access to the full range of asset classes,” he says.

Ongoing pressure to reduce pension deficits and tackle growing liabilities could be another driver to increase the take-up of fiduciary management among UK pension funds. Add into the equation the ever-maturing nature of the country’s defined benefit (DB) schemes, and there is certainly scope for the approach to catch on more widely.

“For many schemes, there is a change in the stage of the game and the volatility of 2008, in particular, has opened the eyes of trustees to see just how much risk they are carrying,” says Perara. “Schemes are now more like insurance companies and need investment professionals as they reach the end game of their DB fund.”

But not all trustees are ready for fiduciary management. MN Services’ head of business development, Colin English, puts it succinctly: “UK trustees are a cautious bunch”. SEI’s Kapur also believes attitudes will take some time to change. “Trustees are not ready to delegate and need time to get used to the fiduciary management concept,” he says. ■



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