

## Expert view

# Getting risk off the table

## The trend that is driving fiduciary management by Ashish Kapur

Surprise, surprise, volatility is back. The end of May is bringing sunshine but not to trustee boards. Equity markets around the globe are at their lowest 2010 levels, 15 year gilt yields have fallen by 0.6% over the last 3 months and Vix, a measure of fear, is at its highest for a year. So what are trustees going to do about it? These are times for taking action and for trustee boards this could mean delegating to a fiduciary manager who can monitor funding levels constantly and react more responsively to changes in market conditions.

Fiduciary managers recognise that pension scheme assets exist to satisfy a stream of future liabilities. Therefore the first thing a fiduciary manager will do when appointed is to agree the pension scheme's long-term goal and then design a path to get to that goal. Once the goals are agreed, the fiduciary manager will analyse the risks to the pension fund and work out which risks are most important. This can be achieved through modelling which helps the trustees and sponsors to understand the levels of risk embedded in the pension portfolio and to find a risk level that is acceptable to them. This first stage of the fiduciary management process is all about identifying, quantifying and prioritising risk.

The next stage is all about implementing the agreed investment strategy within the risk constraints and goals set in the last stage. The assets will be invested in a risk controlled and diversified manner and at the same time the liabilities may be hedged where possible using the most appropriate instrument which may include a combination of physical bonds, swaps and swaptions. Not all liabilities are created equal. Some liabilities such as those relating to pensioners may be treated

differently versus those of an active member. This is because a pensioner will have an immediate need for income whereas the active member will be some years away from retirement. A fiduciary manager should take these points into account when designing an implementation considering how the liabilities are structured and what kind of tool might be used to offset each liability and its specific duration.

All of this may seem recognisable to anyone familiar with a Liability Driven Investing (LDI) approach. The key difference between LDI products and fiduciary management is the ongoing and dynamic nature of the monitoring and management of assets and liabilities. The process we have described in this article doesn't just happen once a quarter. The fiduciary manager will analyse where the risks are for the individual scheme on a regular basis and determine what, if anything, has changed in terms of the market, the economy and the liabilities. Based on this, changes such as selling an asset or protecting against an expected down-side could be taken to increase the likelihood that the pension fund remains on the agreed path to funding. This dynamic approach and greater focus on risk is what is needed to lead pension schemes out of the shadows of their past.

For further information about SEI's Fiduciary Management offering please visit [www.sei.com](http://www.sei.com) or call us on 0207 297 6408

