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Making fiduciary management easier

May 2016

Introduction

The wonders of fiduciary management fill the pensions periodicals, and indeed if you are a board of trustees you can almost be made to feel guilty if you have not yet plunged into the warm waters of fiduciary management ('FM'). However, you will struggle to find much legal commentary on the important legal issues surrounding FM. This is rather surprising when one considers that at its heart FM is about delegating much of the management and decision-making around the operational aspects of the trustees' investment responsibilities to a third party, whilst the trustees retain ultimate liability.

At the very, least therefore, FM throws up some interesting and challenging governance issues for trustees. Amongst all the hype and praises heaped on FM by its main providers to the effect that the quality of decision-making markedly improves where the expert fiduciary managers are put in charge, you will not find much explanation as to the legal framework used for implementing FM. After all, trustees are entitled to ask of the providers, given they are paying a lot of money for their expertise: "what responsibility are you bearing if you get it wrong (and we get poor value) or you fail in your duties? We carry the liability but what recourse do we have against you?" Another aspect which may seem a little strange to trustees and members alike is the apparent distance of trustees from any investment responsibilities that arises if they adopt the FM approach to investment governance.

The obvious conclusion to draw is that the drafting of the documentation governing the relationship between trustees and fiduciary managers needs to be very carefully thought through so that the end result represents a fair balance between risk and reward for the provider. Note that FM is one of a number of similar products – 'implemented consulting' is another similar type of service. Whatever the label, the legal issues to consider in each case will usually be the same.

8 Steps to making fiduciary management easier

What are the key provisions to look out for in an FM agreement? Here are some suggestions for a checklist of issues:

1. *Scope of the services*. Clearly the services should be very carefully scoped out and checked against the pricing. The trustees do not want to be paying for unwanted services or for services already covered by their investment committee or their existing investment consultants.
2. *Fee levels*. Are the fees clear? Particularly where the investment involves a combination of pooled funds and an overarching FM agreement, the trustees may need to ask the provider to summarise clearly how the different fees fit together.
3. *Relationship with third parties*. The trustees need to work out how the services fit alongside those that will continue to be provided by the investment consultants, administrators and custodians. They should ensure that these responsibilities interlock so that at all times it is clear who is responsible for doing what (and at what times) and, if errors creep in, who is responsible for rectifying them.
4. *Liability*. If the trustees remain ultimately liable for the acts and omissions of their delegates, then they will be particularly keen to ensure that remedies and penalties (financial or otherwise) are clearly set out and are stringent. Fiduciary managers sell themselves on the basis that they save trustees time and money – otherwise they have no *raison d'être* – so why should they be rewarded for failure?
5. *Entire agreement provisions*. Fiduciary managers will have promised much to win the trustees' prestigious appointment. Consider whether the key representations should form part of the agreement and should be underpinned by suitable undertakings and warranties governing quality of service.
6. *Validity*. Check the scheme provisions to ensure that the trustees have power to appoint fiduciary managers and to delegate the relevant functions to them. Most importantly, check that the appointment complies with the requirements of the Pensions Act 1995 relating to the delegation of investment decisions. This is a critical legal point on which the trustees must obtain legal advice.

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7. *Monitoring*. Again, this is another headline issue. "Who guards the guards?" is a saying that is particularly apt here. Fiduciary managers themselves emphasise the importance of transparency so that trustees can readily ascertain that the managers are doing what they are being paid to do. But what are they being paid? What financial benefits may they be deriving from the hiring and firing of the underlying fund managers? Are they complying with the terms of the Statement of Investment Principles or implementing exactly the trustees' investment strategy? Are there any conflicts of interest arising from implementation of the strategy? If so, have they been declared and how are they being handled? Is the hiring and firing of managers justifiable? Indeed, who is doing the monitoring – the investment committee and/or the investment consultants? Has that particular function been clearly delegated by the full trustee board?
8. *Termination*. The trustees may well need advice on the framework for appointing, and terminating any appointment of, the fiduciary managers, including making provision in the event of persistent failure to attain the necessary quality of service and for handover.

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Summary

If trustees conclude that the size of their scheme and their investment strategy are such that FM offers them value in terms of time and cost savings, there are still a number of tricky legal issues that will need nailing down in the interests of risk reduction and good scheme governance. In particular, attention needs to be paid to getting the risk/reward balance right when considerable responsibility is to be delegated to specialist fiduciary managers.

Pensions law can be tricky… but it doesn't have to be. These 'making it easier' guides explain key issues in simple terms, giving practical help to trustees and employers.

The series is growing; additional copies can be downloaded from www.pinsentmasons.com

Current topics include: Using advisers; Scheme changes and Becoming a trustee

Comments and ideas for further topics are welcome…

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