



A trustee guide to:

# Choosing an investment governance model

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# Introduction

## Purpose of this guidance

This guide has been produced as part of our response to the Competition and Markets Authority's Investment Consultancy and Fiduciary Management Market Investigation Order 2019<sup>1</sup> ('CMA Order'). In this guide we have focused on two models, investment consultancy and fiduciary management. You should be aware that there is a spectrum of governance structures and levels of delegation between these models, which can be put in place to meet the investment governance needs of your scheme.

Choosing an appropriate investment governance model is important to ensure that you can make timely investment decisions, access appropriate advice and implement your investment strategy efficiently.

<sup>1</sup> [https://assets.publishing.service.gov.uk/media/5cfdfa86e5274a090f9eef8e/Order\\_investment\\_consultants.pdf](https://assets.publishing.service.gov.uk/media/5cfdfa86e5274a090f9eef8e/Order_investment_consultants.pdf)

## What is investment consultancy?



We discuss duties introduced by the CMA Order in our **guide to setting objectives for providers of investment consultancy services**. In relation to those duties, the term ‘investment consultancy services’ has a specific meaning. For the purposes of this guide, we discuss investment consultancy more generally.

Under the investment consultant advisory governance model, the strategic investment decisions are taken by the trustees following advice from the investment consultant. Day-to-day investment decisions, such as which individual investments to hold, are delegated to the investment managers who have been appointed by the trustees.



You will also find further information about the full range of services that an investment consultant may provide to trustees in our **guide to setting objectives for providers of investment consultancy services**.

This model is often suitable where the investment arrangements are not overly complex, the trustees have sufficient time and access to expertise to make timely investment decisions or the trustees have an investment sub-committee or are supported by an in-house investment team.

In the table below, we have illustrated the roles and responsibilities of different parties in relation to a number of key investment activities for a simple investment advisory governance scheme. The allocation of roles and responsibilities can vary significantly between schemes, depending on their governance structure and the resources available to them. For example, some schemes may engage multiple advisers, may retain an investment sub-committee or have in-house investment support or investment management.

It can be helpful to trustees to complete bespoke analysis for their scheme to understand the allocation of responsibilities and roles in relation to key decisions and actions for their scheme. This can help trustees to assess whether the governance structure they have is appropriate and whether it enables decisions to be made and actions to be taken in a timely basis by appropriate individuals.

### Example investment consultancy advisory governance model

Activities	Trustee board	Investment consultant	Asset manager
<b>1. Strategy</b>			
Set investment beliefs	Responsible	Advise	-
Set scheme objectives	Responsible	Advise	-
Set strategic asset allocation (SAA)	Responsible	Advise	-
Set allowable investments	Responsible	Advise	Execute
Set hedging and risk targets	Responsible	Advise	Execute
<b>2. Implementation</b>			
Implement SAA	Responsible	Advise	Execute
Select managers	Responsible	Advise	-
Investment and risk monitoring	Responsible	Advise	-
Transition assets	Responsible	Advise	-
Advice on investment terms	Responsible	Advise	-
<b>3. Monitoring</b>			
Monitor asset performance	Responsible	Advise	-
<b>4. General</b>	-	Advise	-

## What is fiduciary management?



Duties introduced by the CMA Order are discussed in our **guide to tendering for fiduciary management services**. In relation to those obligations, the term ‘fiduciary manager’ has a specific meaning. For the purposes of this guide, we discuss fiduciary management more generally.

Fiduciary management is a form of governance model involving the delegation of investment powers to the chosen fiduciary manager. There are a number of services and levels of delegation available to trustees. Some trustees delegate the management of all of their assets to the fiduciary manager (“full fiduciary management”), while others may only delegate a part of their portfolio (“partial fiduciary management”). By delegating certain investment decisions to a fiduciary manager, pension scheme trustees should be able to focus more on high-level strategic issues.

As with all governance models, the trustees ultimately remain responsible for the scheme. This includes setting the overall investment strategy and monitoring the activities and performance of their fiduciary management service provider(s) to ensure they are operating in accordance with the trustees’ legal obligations and are delivering good scheme and member outcomes.

As under the investment consultancy model, the fiduciary manager may provide strategic advice, initially and from time to time. However, under the fiduciary model, initial and ongoing implementation of the mandate is delegated to the fiduciary manager for the scheme assets they have been allocated.

The allocation of responsibilities and roles in relation to key decisions and actions for a scheme, which has delegated part of its portfolio of assets under a (partial) fiduciary management governance model, is illustrated in the table on page 7. For this illustrative model, the scheme’s investment consultant:

- continues to provide investment advice on the assets outside of the fiduciary management mandate
- provides overall strategic advice to the trustees, and
- provides oversight on the performance and ongoing suitability of the fiduciary management mandate.

Trustees should be aware that a wide range of governance models can be adopted when either full or partial fiduciary management is implemented, and the model selected should be appropriate for the needs of their own scheme. Trustees should also be aware that under some structures:

- The fiduciary manager provides all the strategic investment advice (and implementation of that advice). The existing investment consultant or a third party adviser typically helps the trustees to set the investment beliefs and scheme objectives as part of the fiduciary manager appointment.
- The trustees appoint (or retain) a separate strategic investment adviser to work alongside the fiduciary manager (and to provide oversight of the fiduciary manager).

### Example partial fiduciary management governance model

Activities	Trustee board	Fiduciary manager	Investment consultant
<b>1. Strategy</b>			
Set investment beliefs	Responsible	-	Advise
Set scheme objectives	Responsible	-	Advise
Set strategic asset allocation (SAA)	Responsible	Advise	-
Set allowable investments	Responsible	Execute	Advise
Set hedging and risk targets	Responsible	Execute	Advise
<b>2. Implementation</b>			
Implement SAA	Monitor	Responsible	-
Select managers	Monitor	Responsible	-
Investment and risk monitoring	Monitor	Responsible	-
Transition assets	Monitor	Responsible	-
Advice on investment terms	-	-	Advise
<b>3. Monitoring</b>			
Asset performance	Responsible	Advise	-
Fiduciary management mandate performance	Monitor	-	Advise
<b>4. General</b>			
	-	Advise	-

# Key matters to consider before choosing an investment governance model

## Summary

Once you understand how the different investment governance models operate, you should:

- identify your current investment governance capability and how it is likely to evolve in the future (for example, when a number of key trustees might retire)
- define and agree your investment beliefs
- define and agree your objectives for the scheme
- consider the extent to which you want to delegate investment decisions to an investment sub-committee or a third party investment or fiduciary management service provider
- consider whether other options are more desirable, for example appointing a professional trustee, transferring into an alternative arrangement or winding up the scheme (DC)
- consider how each governance model might help you deliver your scheme objectives, in line with your investment beliefs
- consider the extent to which total ongoing costs may vary between each investment governance model and the extent to which each approach might add value and/or improve outcomes.

## Reviewing investment governance capability

A review of your current investment governance capability will help you identify any issues that you need to address and help you to consider which investment governance approach might support you. You may wish to run an effectiveness review to highlight your strengths and weaknesses. This could be an internal review completed by the trustees or could include the involvement of an external party to provide the trustees with an independent view.

If the trustees feel their current scheme governance structure and circumstances give rise to a concern, they should consider the extent to which changes are necessary. This could, for example, include:

- the appointment of a professional trustee (or an additional professional trustee) with specific skills and experience in relation to investment
- the creation of an investment sub-committee
- the review of the extent of delegated authority provided to the investment sub-committee to enable decisions to be made and implemented, and/or
- the expansion of the trustee board and sub-committee roles, for example by increasing the membership or by increasing the time commitment required to perform those duties.

Where trustees are concerned that they may not have the necessary investment expertise or governance capabilities within the board, they may wish to consider delegating those activities in order to optimise investment outcomes.



For further information about reviewing the effectiveness of your governance, see our **scheme management skills guidance**.

### Key questions to ask yourself when reviewing your governance model

- Do we have sufficient time to dedicate to investment and risk management?
- Do we have the resources to set up an investment sub-committee?
- Do we need to meet more frequently to make timely decisions?
- Do we need to react quickly to investment decisions in between meetings?
- Do we have the relevant knowledge and experience on our board to understand the investment and risk management needs of the scheme? Can we recruit or co-opt people with the required skills?
- Could the governance be improved by some other changes? For example, by meeting more frequently, by appointing a professional trustee or by introducing an investment platform?
- Do we need a complex investment portfolio to meet the scheme's needs?
- How might things vary in the future (eg after the current trustees retire)? Do we have a succession plan to recruit trustees with the right knowledge and skill set?

## Define and agree investment beliefs

As a trustee board, you should establish a set of core investment beliefs as these can help focus and improve the effectiveness of your investment decision-making. These can also help you to set more appropriate objectives for the selection and appointment of your service providers and help you to identify the most appropriate investment governance model for your scheme and trustee board. If, as a board, you do not understand or have enough experience to agree your investment beliefs, you should seek advice from your existing service providers and/or consider appointing an independent third-party adviser, with specific investment experience, who will be able to assist you.

When setting investment beliefs, you should be aware of the potential for bias and conflicts of interest to arise. For example, an investment consultant's approach to setting beliefs may be influenced by the capability and range of services that their firm offers.



For further information and examples of investment beliefs, see our **DB investment guidance** and **DC investment guidance**.

## Define and agree scheme objectives

Your scheme objective(s) will influence which governance model will be most appropriate for your scheme and support the development of your selection criteria for any tender exercise. You should agree and document your scheme objectives.

**Please note:** The following examples are for illustrative purposes only. When agreeing your objectives, you should consider what is appropriate for the needs of your scheme.

## Example objectives

DB scheme considerations	DC scheme considerations
<p>The scheme objectives will be based around your duty to pay benefits promised in accordance with your scheme rules as and when they fall due.</p> <p>They will also be linked to the statutory funding objective which requires that sufficient and appropriate assets are held to cover your scheme's technical provisions (TPs).</p>	<p>The scheme objectives should consider how the needs of your members might vary in the period before they begin to access their benefits (the accumulation phase) and when they are accessing their benefits (the decumulation phase).</p>
Examples	Examples
<ul style="list-style-type: none"> <li>• To meet member benefit payments as they fall due.</li> <li>• To reach full funding on the TPs basis by [date].</li> <li>• To reach full funding on a low dependency basis by [date].</li> <li>• To deliver a return over the liabilities of X% per annum (reducing to Y% per annum after N years) within a specified level of risk.</li> <li>• To effect a series of insurance company buy-ins of membership tranches on a phased basis as and when market pricing is favourable.</li> <li>• To transfer the remaining scheme liabilities to another arrangement or insurance company within N years.</li> <li>• To buy out the benefits with an insurance company.</li> <li>• To fully integrate ESG and climate change into the implementation of the scheme's investment strategy.</li> </ul>	<ul style="list-style-type: none"> <li>• To provide investment solutions that provide value for members and good member outcomes over the long-term.</li> <li>• To ensure that the investment strategy structure is based on the membership profile.</li> <li>• To establish an investment strategy for the default fund that is suitable for a typical member who does not wish to make their own investment decision.</li> <li>• Within the default fund to generate returns significantly above inflation while members are a long way from retirement and switch gradually into lower risk investments as members near retirement.</li> </ul>

## Governance model costs

The structure of the governance model selected will influence the costs. It is important to consider the total costs of any governance models being considered, including direct investment fees, performance fees, transaction costs and any potential costs that might be incurred in future if a decision was made to exit from the chosen model.

It is also important to understand that “costs”, which may be broadly the same at an aggregate level, may be structured differently. For example, a fiduciary manager might submit a low fee for the core fiduciary management element of the service but include higher costs for the costs of the underlying investment management.

Trustees should not consider costs in isolation. The potential value and improvement in outcomes that might be achieved using different governance models should also be considered.

## Conflicts of interest

When considering which governance model is appropriate for your scheme, you should be aware of the potential for a wide range of conflicts of interest to arise. The scale of conflicts will vary and may apply to a wide range of parties that might be involved. For example:

- the existing investment consultant may be linked directly with a firm that offers a fiduciary management service
- the existing investment consultant, who has no links with a firm that offers fiduciary management services, but who is retained on an advisory basis, will have a commercial interest in an advisory relationship continuing
- some third party evaluators will have a commercial interest in trustees choosing fiduciary management to generate business, for example where they offer an ongoing oversight role
- third parties will have a commercial interest in assisting with the tender exercise but may not have the necessary knowledge of the fiduciary management and investment consultancy markets within the occupational pension scheme markets to advise appropriately.

Conflicts of interest should not be a barrier to appointments or decisions being made. However, you should ensure that appropriate measures are in place to identify, mitigate and manage those conflicts.



Further examples of the potential conflicts that can exist are found in **Appendix A: Examples of third party evaluators** in our **guide to tendering for fiduciary management services**. Further information about managing conflicts of interest can be found in our **conflicts of interest guidance** and our guide on **scheme management skills**.

## Additional factors that may influence the governance model you select

Your scheme circumstances, investment objectives and investment beliefs should influence the governance model that you adopt. The importance of individual factors will vary between schemes and trustees should consider the unique circumstances of their own scheme, their governance structure and how it might evolve.

Factors that might have a significant effect on the decision for some schemes could include, for example, the extent to which the trustees:

- want to delegate investment decisions
- believe other options might be more desirable, for example improvements to the trustee board and governance structure
- are confident in their investment beliefs, for example their belief in the ability of active investment and asset allocation management to add value
- need to generate investment return and/or manage risks to restore funding to a level to be able to meet future benefit payments.
- believe the scheme is likely to run on for a period of time (and not transfer to another arrangement).

## Examples to consider

### Scheme A

The trustees believe in passive management and can adopt a low-risk investment strategy. They do not need a very active governance solution and have sufficient time and resources to devote to the scheme's investments. The trustees concluded that an advisory governance model is more suitable for their scheme.

### Scheme B

The trustees need a high-risk investment strategy to deliver strong returns, but their knowledge of sophisticated investment and risk management techniques is limited. They believe in active management but do not have the time or resource to select and monitor numerous managers, and the scheme size is prohibitive to achieving suitable diversification. Given their existing commitments and trustee board composition, they would not be able to dedicate sufficient time and resource in the foreseeable future to enable the trustee board to actively engage with the investment and risk management arrangements for the scheme.

The trustees therefore conclude that a fiduciary management model could be more suitable in supporting them to meet their primary investment objective (to meet members' benefits in full as they fall due) in the longer-term and should be investigated.

### Scheme C

The trustees of a rapidly growing DC scheme have sufficient knowledge and understanding of investments but are time constrained. They want to focus their attention on improving engagement with members and developing their understanding of their members' benefit needs to ensure they provide them with an appropriate level of information, support and access to investment fund options during the accumulation and decumulation phases. The trustee board decides to set up an investment sub-committee to work directly with their investment adviser.

### Scheme D

The trustees of a DC scheme believe that some active managers can add significant value. The trustees also believe that tactical and medium-term asset allocation decisions can lead to improved outcomes. However, the scheme does not have sufficient scale to incorporate active fund management within the DC default fund charge cap, and the trustees are not confident of their ability to:

- consistently identify, select and transition investment managers on a cost-efficient basis to ensure that member outcomes are improved
- make investment decisions on a sufficiently timely basis to enable medium-term asset allocation decisions to add value.

The trustees therefore concluded that transferring members to an authorised master trust with the benefit of scale and greater investment governance resource could be more suitable in meeting their objective to improve member outcomes, and with more potential to align with and implement their published investment beliefs.

## Requirement to set objectives for providers of investment services

Whether the governance model you select is advisory, fiduciary or a hybrid of these models, you need to set objectives for providers of investment consultancy services.



See our **guide to setting objectives for providers of investment consultancy services**.

## Where can I find out more?



### For DB schemes

- DB investment guidance

### For DC schemes

- A guide to investment governance

### For DB and DC schemes

- A guide to tendering for fiduciary management services
- A guide to setting objectives for providers of investment consultancy services

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