BARNETT WADDINGHAM
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Briefing

Trustee investment governance

RISK | PENSIONS | **INVESTMENT** | INSURANCE

Good governance enhances decision making and ultimately improves outcomes. This is our fundamental belief and it has particular financial significance when it comes to pension fund investing.

This importance of good governance has been reflected in the new requirements and regulatory guidance, following the publication of the Competition and Markets Authority (CMA) review of the UK investment services industry.

Notably we have seen the publication of the Pensions Regulator's trustee guidance on 'Choosing an investment governance model'. The Pensions Regulator says in its guidance:

> "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."
>
> THE PENSION'S REGULATOR
> A trustee guide to choosing an investment governance model

The purpose of this briefing note is to help trustees consider how to approach the question of how they govern their pension fund's investments and whether any changes could be beneficial.

Do we need to enhance our current approach?

Whatever the context, whenever considering whether any change in approach is necessary, it is usually sensible to reflect on whether there is anything that can be materially improved. In the context of trustee investment governance, we think this can be categorised by whether decisions relating to the investment of assets are being made effectively and efficiently.

From time to time however, we do sometimes see trustees express a desire for change. The expressions listed in the box below may resonate with some trustee boards as issues they face.

Potential issues facing trustee boards

- We don't have the time or expertise to run a sophisticated investment strategy
- We aren't able to react quickly enough to capture market opportunities
- We find it hard to evaluate the quality of the advice we receive and the decisions we take
- We are hesitant in making portfolio changes due to the time and cost involved with appointing new managers

For trustee boards which do consider there to be areas for improvement in how investment decisions are taken, the range of solutions is varied. What options are best depend upon the nature of the issue you are aiming to address – correctly identifying the issue at heart is therefore key to deciding on the right solution for you.

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How can trustees enhance their investment governance?

We have summarised below five possible ways of enhancing pension fund investment governance. These approaches will not always be enhancements – it depends whether there are any issues which need solving.

1. DELEGATING DECISIONS TO AN ASSET MANAGER

Delegating investment decision making to an asset manager can address many of the potential governance issues for trustees.

All pension fund trustees delegate investment decision making to some extent, for example when it comes to stock or bond selection. In recent years, we have seen a trend toward the delegation of higher-level allocation decisions, for example the delegation of selecting asset classes through investing in 'diversified growth funds' or 'multi-asset credit funds'.

Some pension funds opt to delegate all but the most strategic of investment decisions to a single provider, or 'fiduciary manager', who will have an investment mandate to outperform liabilities by a specified amount.

Whatever the approach to delegation, it brings with it issues to consider, such as trustee accountability, control and, of course, cost.

Where trustees are interested in considering their approach to delegation further, we would encourage undertaking an exercise in determining which decisions you would like to retain as a board and which you would like to pass on to an asset manager.

Determining responsibilities

	TRUSTEES	INVESTMENT CONSULTANT	ASSET MANAGER
Setting objectives	Decide	Advise	
Strategic asset allocation	Decide	Advise	
Liability hedging	Decide	Advise	Execute
De-risking (e.g. SAA)	Decide	Advise	Execute
Growth portfolio allocation	Decide	Advise	Execute
Tactical asset allocation	Decide	Advise	Execute
Fund manager selection	Decide	Advise	
Stock/instrument selection	Monitor	Monitor	Decide
Investment performance	Monitor	Monitor	
Asset transition management	Decide	Advise	Execute
Regulated investment advice	Monitor	Decide	

2. DELEGATING ADMINISTRATION TO AN INVESTMENT PLATFORM

For many trustees, delegating the management of all of a pension fund's assets to one provider might conjure an image of a sledgehammer and a nut. Where frustrations exist with the process and timescales for making changes to your portfolio, for example when hiring a new fund manager, a more proportionate approach could be to invest via an investment platform. This approach involves entering into a single contract with the platform provider and making changes by instructing the platform to add or remove funds to the portfolio, without the need for significant additional paperwork.

Here, trustees are delegating administrative investment matters to the platform provider. Usually most if not all of a pension fund's existing investments can be added to a platform and it is possible that the fees payable on some funds may be lower due to pooling with other investors.

3. REVIEWING YOUR INVESTMENT CONSULTANT'S ADVISORY OBJECTIVES

It may be possible to solve certain investment governance issues by modifying the remit of your investment consultant. Experience shows that trustee boards have different preferences toward how they like to receive advice. For example, some boards like their consultant to bring a range of options to the table for discussion, whereas others prefer a more directive approach.

Although reasonably nuanced, being clear with your consultant about how they should advise you and reflecting this in their statutory advisory objectives could materially impact the speed at which investment decisions are made. Having clear objectives in place can also help with evaluating the quality of the advice and service provided by your consultant.

4. REVIEWING TRUSTEE BOARD STRUCTURE AND PROCESS

The structure of trustee boards and their decision making processes also vary greatly from pension fund to pension fund. Simply meeting more frequently may be an option for some boards. However, the availability of time to dedicate to trustee meetings is often considered to be the greatest constraint for trustees for whom pensions is not 'the day job'.

Where time is the issue, possible solutions include:

- Forming an investment sub-committee enables a trustee board to delegate some elements of investment decision making to a subset of board members who do have more time and/or investment experience to consider implementation aspects such as fund manager selection, performance monitoring and cashflow management.

  This enables the full board to focus their limited time on the more strategic issues in meetings. Sub-committees may also include representation from the pension fund sponsor, which can speed up the sponsor consultation process considerably.

- Adopting specified in-meeting decision-making processes can make meetings work more effectively, where there is a tendency to talk around a subject for a while without reaching a consensus.

  Seemingly simple tools like including time expectations for different agenda items or an explicit trustee voting policy for material decisions can have a material impact on the efficient running of meeting.

- Adopting protocols for decision-making between meetings can enable trustee groups to react quickly to events and/or opportunities which arise at short notice, e.g. to enable conference calls to take place at short notice. Examples of this might include where a funding level de-risking trigger has been hit or where funding is needed to address the collateral requirements of a LDI portfolio.

- Video conferencing became an effective and almost universally accepted means of communication within the early days of the global Covid-19 pandemic. It surprised a lot of people, ourselves included, in just how quickly the world adapted to meeting virtually.

  We believe it is here to stay and the potential benefits are wide ranging from a governance perspective, from more flexibility around meeting times to more effective use of technology, for example in voting on decisions. We would suggest that all trustee boards consider how virtual meetings can be used alongside in-person meetings in future.

Appointing a professional trustee

Alternatively, **where expertise is the issue** then appointing a professional trustee with specialisms in the required areas can make decision making easier in certain areas. There are other potential governance benefits in addition to decision making, such as managing conflicts of interest and co-ordinating meetings and advisers.

5. PAYING INVESTMENT ADVISORY COSTS THROUGH THE PENSION FUND

Historically investment management expenses have almost always been paid directly by pension funds, whereas investment advisory costs (and other advisory costs) have quite often been met by the pension fund sponsor. Arranging the payment of expenses in this way creates a risk of deferring consideration of some of the most financially significant aspects of a pension fund's investment strategy, since there may be pressure on trustees to keep advisory costs down. Meanwhile significantly higher costs are being paid through the pension fund for often much less financially significant fund management decisions, such as stock selection.

A solution is to pay investment advisory costs through the pension fund, where this does not happen already. This has a clear governance benefit for the trustee board by relaxing a constraint around taking advice, and helps the sponsor by enabling the cost of expenses to be spread over time, through regular funding contributions. The actuarial, legal and tax implications of this approach would need considering, and the Schedule of Contributions could need updating.

Summary and what next?

The approach taken by trustee boards to governing their pension fund's investments has always been something which has potential to enhance outcomes, but it is now under the spotlight more than ever.

We strongly encourage trustees to reflect on their experience of making investment decisions and consider whether this could be enhanced in future.

Where issues exist, in many cases they may be solvable by subtle adjustments, for example by changing the way you receive or respond to investment advice, or by the way in which costs are met.

In other cases, a more fundamental review may be appropriate, looking at what investment decisions are delegated to asset managers and whether use of an investment platform can speed up the implementation of trustee decisions.

Our investment consultants are experienced at advising trustee boards on the full range of investment governance issues and solutions. If you would like to consider this further then we would be delighted to assist.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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