FIDUCIARY MANAGEMENT

Defined benefit (DB) pension plan sponsors have almost exclusively operated a traditional approach whereby oversight and decision-making for a DB plan is made by committee supported by non-discretionary advice from consulting firms.

This article looks at shortcomings of the traditional approach alongside the features of an alternative approach - fiduciary management - which embodies delegation of functions and decisions while allowing plan sponsors to retain control of the overall objectives.

WHERE WE HAVE COME FROM

Most DB plans adopt a policy asset mix that has a low allocation to matching fixed income assets and higher equity allocation in pursuit of higher returns.

In the bull market environment that characterized the 1980s and the 1990s, the traditional approach generally delivered good outcomes for most pension plan sponsors with many seeing the value of pension assets materially outgrow the value of the liabilities.

The shortcomings of the traditional approach started to be revealed with the bursting of the technology bubble in early 2000 and the adverse impact that it had on the financial position of DB plans.

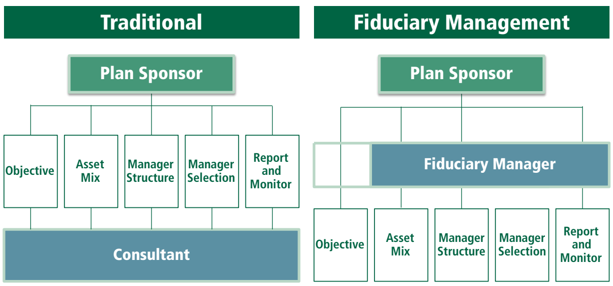
The financial position of DB plans continued to suffer with the global financial crisis in 2008/09, and the continued decline in long-term fixed income yields has contributed to the growth in the value of the liabilities materially outpacing the growth in the value of assets.

The current volatile markets, fueled by the troubles in Europe, suggest that more challenging times are still to come.

Often a plan's governance structure has not evolved to keep pace with the increased complexity in overseeing the DB assets, and many plan sponsors have limited internal resources dedicated to the oversight of the DB plan. This has made it difficult for many plan sponsors to react to the market environment and to embrace new asset classes and strategies to combat volatile markets.

HOW DO THE DIFFERENT APPROACHES COMPARE?

The chart below illustrates how the traditional approach and the fiduciary management approach compare.



Under the traditional approach the plan sponsor is ultimately responsible for making the decisions, such as setting objectives, determining asset mix, determining manager structure, selection of investment managers and plan monitoring.

The consultants play an important role in providing information and advice, but have limited accountability and incentive for a plan sponsor to adopt their recommendations, since it generally does not impact how they are compensated

Under the fiduciary management approach, the fiduciary manager is made accountable for the outcome for many of the tasks by being elevated to a higher position in the decision-making process.

One area where the fiduciary manager provides advice and input, but the responsibility remains with the plan sponsor, is with respect to determining the overall plan objectives.

The level of delegation by the plan sponsor to the fiduciary manager will vary depending on the resources and preferences of the plan sponsor.

COMMON CONCERNS

There is a natural hesitancy when it comes to delegating. For those contemplating a fiduciary management approach, some common concerns are summarized in the following table along with an opposing comment.

CONCERN	COMMENT
We don't want to delegate all decisions and lose control	It's about delegating the right decisions, not all decisions
We won't be involved with investments anymore	Still involved, but now have a more strategic focus
Once we change the approach, we're locked in	It's not an irreversible decision
Costs are likely much higher	Better expected outcome, net of fees

WHAT ARE THE BENEFITS FOR PLANS SPONSORS?

The table below summarizes the areas of expertise and benefits the fiduciary management approach can provide to plan sponsors.

FIDUCIARY MANAGEMENT	BENEFIT FOR PLAN SPONSORS
Firsthand experience in public and often private market investments.	Ability to draw on practical investment experience in a range of traditional and non-traditional investments.
Significant risk-based investment experience in a range of investment mandates.	Comfort of knowing the firm's high degree of risk management expertise.
Dedicated teams of professionals oversee non-investment management activities, such as operational, risk and compliance management.	Convenience and confidence in a single point of contact for all operational activities and fully integrated and consolidated performance and risk reporting.
Operational experience often incorporates public and private market administration.	Confidence in being able to access both public and private market assets to enhance the DB plan risk and return profile.

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