



Investment  
Solutions

**Fiduciary  
Management  
Solutions**

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The source for all figures and charts is Investment Solutions Limited. The examples used in this brochure are for illustrative purposes only. The information contained in this document is for educative purposes only and does not constitute investment advice.

This document is intended for and directed at members of trustee boards, investment subcommittees, or persons with similar responsibilities of defined benefit pension schemes, and their professional advisers only. The information contained within it should not be relied upon by anyone else.

Schemes wishing to implement Fiduciary Management Solutions MUST obtain advice from their professional advisers as to the suitability of fiduciary management, prior to embarking on this solution.

# What is Fiduciary Management?

Fiduciary Management Solutions (FMS) is a service that allows our clients to outsource the running of assets relative to the scheme's liabilities to Investment Solutions. This approach aims to enhance the existing decision-making framework by offering an investment service that seeks to add value in all areas.

The key benefit is that the service allows trustees to outsource all the decision-making (within a pre-agreed mandate) to people whose everyday job is to look after investments. This not only accelerates the speed of decision-making, it opens up the potential to capture windows of attractive buying opportunities. In addition, pension schemes can now benefit from the most innovative investment thinking, which should lead to a more stable funding level.

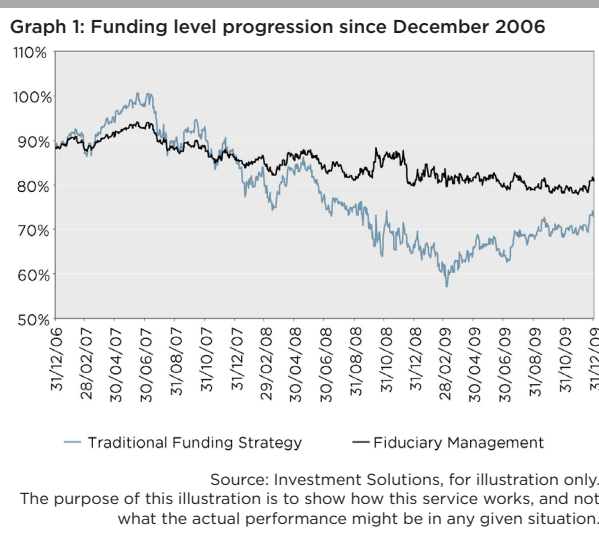
The real-time approach, the use of the best investment technology and the outsourcing of decision-making has strong potential to add value to the financial health of a pension scheme relative to the existing approach. An illustration of what we would have looked to have achieved over the last few years is shown in graph 1, where the black line represents the funding level under the FMS service and the blue line is what the client would have experienced under a traditional investment strategy.

In order to achieve our targets, we will perform the following functions:

- Long term Strategic Asset Allocation (SAA) between growth (such as equities) and protection (such as bonds) assets.
- The allocation of the growth assets.
- The allocation of the protection assets.
- Manager selection and monitoring.

In addition, the Fiduciary Manager will also be able to deliver the following value added elements that are missing from the traditional consulting model:

- The right time to buy assets - Tactical Asset Allocation (TAA).
- Locking in scheme returns and reducing volatility over the longer term.
- The real-time management of the assets relative to the liabilities provides clear benefits for trustees.



# The Benefits of Fiduciary Management

The largest pension schemes, with their far greater available resources and budgets, are starting to turn to Fiduciary Management for the outsourcing benefits this approach provides. However, we believe the benefits of this approach to be far greater for the smaller pension scheme and we set out the key advantages below.

## Cost

The market cost of setting up the optimal investment strategy for pension schemes is upwards of £200k (consulting advice plus manager selections for several asset classes); before allowing for ongoing monitoring of circa £50k p.a. if trustees carry out the implementation through the traditional consulting route.

Investment Solutions fee is more cost effective than the traditional consulting costs, due to the ability to pool assets and take advantage of economies of scale.

## Knowledge requirements

Pension scheme trustees are expected to have sufficient knowledge on all the investment decisions that they take. Technically, that is an onerous requirement and it is arguable whether many pension scheme trustees meet the necessary knowledge thresholds, not by choice, but through time constraints.

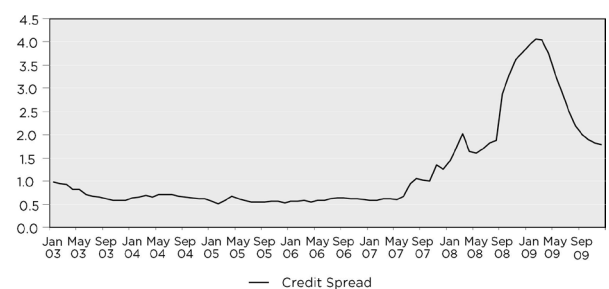
We can help trustees to supplement their knowledge with that of the experts. The trustees are still ultimately responsible for the investments, but the use of a Fiduciary Manager reduces the need to understand each and every aspect of investment knowledge. It now becomes far more important to understand what the appointed Fiduciary Manager is trying to achieve and how they intend to do this.

## Real-time decision-making

Over recent years, we have seen just how chaotic markets can be. The investment world, in general, became a little too complacent in the benign years between 2003 and 2007 and forgot how painful adverse market conditions can be.

This market volatility is not all bad news, and periodically presents investment opportunities for pension schemes. For example, the additional yield available on corporate bonds above gilts was at record levels around March 2009 and from a tactical viewpoint, corporate bonds could have been viewed favourably (see graph 2).

Graph 2: UK Corporate bond spreads



Source: Investment Solutions, for illustration only.

However, when trustees meet only two to four times a year, and typically take at least two meetings to gather the necessary information to make a decision, such opportunities can easily be missed.

In mid 2007, there was a narrow window when average funding levels were close to 100%. It would be a very happy board of trustees that used this opportunity to lock in gains and reduce investment risk, but how many did? Fiduciary Management Solutions operates on a real-time basis and endeavours to ensure that clients rarely miss out on such investment opportunities again.

Every business is run in real-time; it seems illogical that pension schemes worth millions of pounds are not run in the same way.

### State of the art investment arrangements

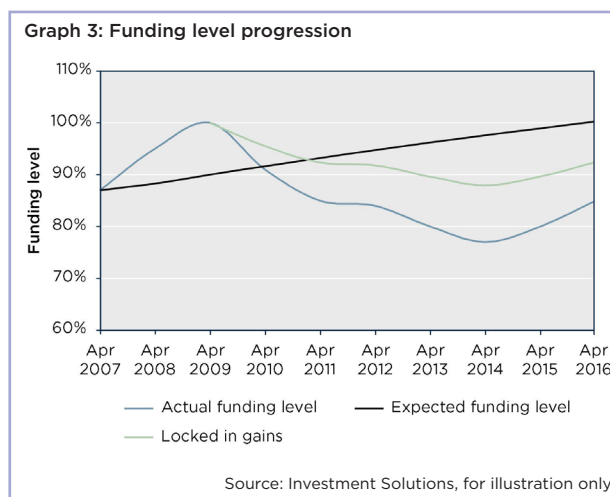
The use of Liability Driven Investment (LDI) bond funds and diversification is crucial for achieving risk reduction within pension schemes. We would aim to make full use of the LDI bond fund range and diversified growth products to ensure that the expected volatility of the investments is controlled in the smartest way.

### A service that pension schemes want

In our experience, many clients have been increasingly in need of an investment manager that will take on responsibility for managing the investment aspects that can affect the funding level. Fiduciary Management provides this service and allows pension schemes to run off their liabilities without having to worry unduly about the investments - this approach allows many of the benefits of buy-out without having to pay the additional implicit costs.

### Value added services

The traditional consulting model allows little scope for pension schemes to benefit from tactical asset allocation or bank favourable experience. These value added areas would be fully integrated into FMS and an illustration of the potential benefits is shown below in graph 3. In this example, the blue line indicates the funding level with no changes made to the strategy. The green line shows how banking good investment news by reducing risk, reduces volatility and can mitigate the downside on funding levels; and the black line represents the expected funding level.



# Fiduciary Management Solutions

The first part of the process is for the trustees to work out, with their advisers, the target level of return required and over what time period. This will depend on numerous scheme specific factors such as the strength of the employer covenant, existing funding level and expected contribution schedule.

Once we get this mandate, we take over the decision-making. Our first step is to carry out an efficient frontier analysis for the client return target, using our key building blocks and in-house modelling tools:

- For growth, we will typically use our diversified growth fund, the Multi-Strategy Fund. We can incorporate client specific requirements if necessary.
- For assets seeking to protect against liability volatility, we will use gilts and the Liability Driven Investment (LDI) bond fund range.

Our ability to take these strategic decisions, utilising the investment expertise we draw on everyday, can significantly reduce the time taken to implement investment strategies.

### Tactical Asset Allocation (TAA)

At Investment Solutions, we believe that it is possible to improve the financial health of a pension scheme by tweaking the long term investment strategy to take advantage of asset valuation anomalies. This process is called Tactical Asset Allocation (TAA).

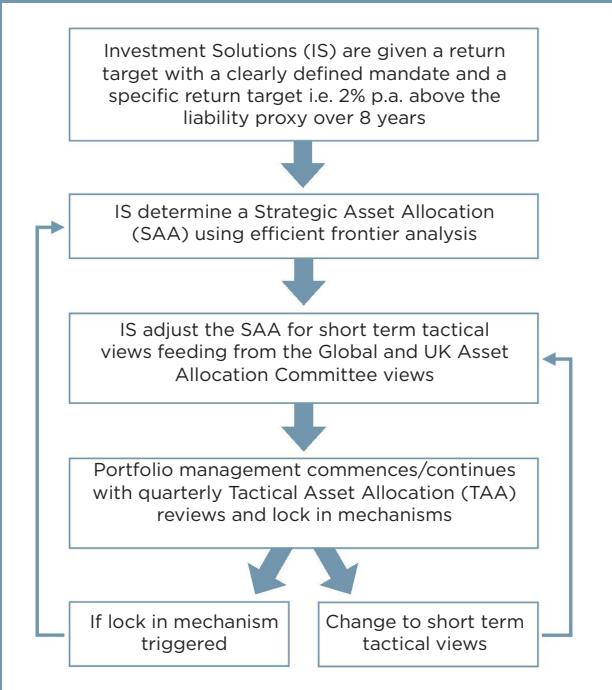
Our TAA Committee, headed up by our Chief Investment Officer, meets on a regular basis to discuss our TAA view; using inputs from a range of sources including our global economic research team.

### Locking in gains

Actuaries value liabilities based on long term gilt yields, therefore, we track the daily movement of funding levels for each client by monitoring actual asset returns relative to a liability proxy derived from gilt yields.

If we find we are in a position where the assets have performed significantly in excess of the liability proxy, we will lock in some of these gains and reduce the risk within the asset portfolio. This is effectively a way for us to sell high and buy low on behalf of our clients.

### Fiduciary Management Implementation



## Case Study

As an example, a client is seeking 2% p.a. outperformance of the assets over the liability proxy over an 8 year period. Using simple arithmetic for ease of illustration, this equates to 16% (8 x 2) over the 8 year period. From our initial analysis using in-house modelling tools, the starting portfolio asset allocation would be 50% in growth assets and 50% in protection assets.

We also have trigger points at which we will make a change to the asset allocation. In this example, we will reduce risk if the return required over the remainder of the mandate falls below 1.25% p.a. Conversely, we will increase risk if the required return rises above 2.75% p.a. for the remainder of the mandate period.

In the first year, the assets outperform the liability proxy by 9%, and the remaining outperformance for the remaining 7 years becomes 7% (16 - 9).

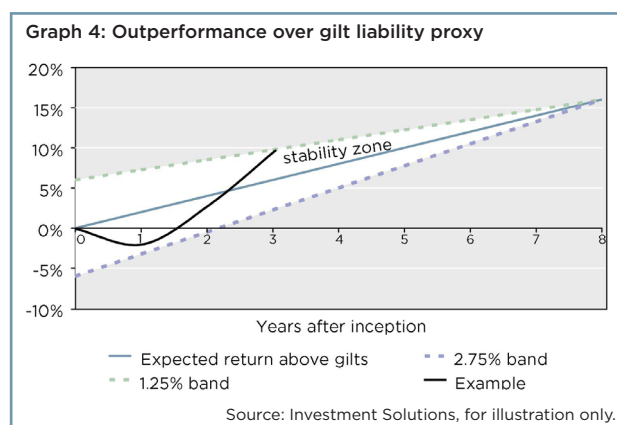
In effect, the assets only need to deliver 1% p.a. for the remaining 7 years to meet the target. We would restructure the portfolio to target 1% p.a. which would have 25% allocation to growth assets and 75% to protection assets.

In year 2, the assets underperform the liability proxy by 5%. For the remaining 6 years, the required return is now 12% (7 + 5), which equates to 2% p.a. We would restructure the portfolio to target 2% p.a. which would have a 50% allocation to growth assets and 50% to protection assets.

The dotted lines in graph 4 show the points at which we would change the return we target in this example. It is evident that as the mandate approaches maturity, the trigger points become much closer and the scheme's asset allocation could change on a more frequent basis if the process is not modified.

This is not ideal as every target return change requires a new asset allocation and hence buying and selling of investments, which will create a drag on the scheme's performance.

Therefore, we will only implement changes to the asset allocation that reduce risk in the last 4 years of the mandate. What this means is that the return target can be reduced, but it cannot be increased over the last years of the mandate.



## Next Steps

If trustees want to use this service they need to complete the necessary investment documentation, for our Trustee Investment Plan (TIP). The TIP is a life policy, which allows trustees to access our investment platform.

Fiduciary Management Solutions is an optional service under which you instruct Investment Solutions to manage the scheme assets against a liability benchmark, once you and your adviser have defined a performance target and the parameters of the mandate.

We will then invest your TIP across a range of funds in accordance with your mandate, with the aim of achieving the performance target; and will report regularly to you on the performance of the TIP.

If you have any questions or would like some further information about Fiduciary Management Solutions and how this would work within your pension scheme please contact your Adviser or our Client Services team.

Investment Solutions  
3rd Floor  
1 Royal Exchange  
London  
EC3V 3LN

t: +44 (0)20 7847 3333

f: +44 (0)20 7847 3399

[enquiries@isltd.co.uk](mailto:enquiries@isltd.co.uk)

[www.isltd.co.uk](http://www.isltd.co.uk)

## About Investment Solutions

Investment Solutions has been providing services to the occupational pension scheme market in the UK since 2003 and specialise in offering small to medium sized pension schemes leading edge investment offerings more commonly found in larger schemes. We believe that the needs of smaller pension schemes under £500m have been largely neglected by the traditional fund manager community. Our focus is to provide an appropriate range of investment tools for the trustees of defined benefit schemes to meet the liability benchmark.

By providing leading edge, best of breed funds through pooled investment, we can offer our clients an outsourced approach to smoothing out returns and reducing risk, while lessening the expense and burden of manager selection exercises and ongoing monitoring. We aim to provide all this with a level of service that would be far higher than could be expected from a large asset management company for smaller clients.

- Funding level partner aiming to restore or improve scheme solvency through appropriate use of our fund range.
- Strategic solutions for small to medium sized defined benefit schemes that match those given to larger schemes.
- Reduction of volatility from investment returns while optimising performance.
- Outsourcing of investment decisions in relation to selection and monitoring.
- Continuous qualitative and quantitative monitoring of asset manager performance, which ensures that performance is consistent with their stated investment style.



# Investment Solutions

**Investment Solutions** 3rd Floor, 1 Royal Exchange, London EC3V 3LN  
**t:** +44 (0)20 7847 3300 **f:** +44 (0)20 7847 3399  
**[www.isltd.co.uk](http://www.isltd.co.uk)**

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