Effective delegation

Claire Collier examines how court cases and legislation can reveal tips for trustees on how to successfully implement fiduciary management

Fiduciary management is becoming an increasingly popular option for UK pension schemes: *Aon Hewitt's 2016 Fiduciary Management Survey,* for example, indicated that take-up rates had more than doubled, from 18 per cent in 2011 to 45 per cent in 2016, while 20 per cent of those surveyed who do not yet use fiduciary management said that they plan to explore or are currently exploring fiduciary management. But legislation and case law in this area is fairly limited, so it can be difficult for trustees to get to grips with how they should go about delegating their investment functions and what limits should be placed on any delegation.

The recent private trust case of *Daniel v Tee*[1] provides helpful (and timely) guidance on the hallmarks, from a legal perspective, of a successful delegation to a fiduciary manager. The case concerned a trust fund with assets of around £3 million, which was set up for the benefit of two children following their father's death in 1999. The trust fund suffered substantial losses following the bursting of the dotcom bubble. The claimants in the case argued, amongst other things, that the trustees did not themselves consider whether the investments made on behalf of the trust fund were suitable or whether the portfolio was appropriately diversified. The trustees had delegated the exercise of their investment powers to one of their number, who had in turn delegated decisions as to suitability to an investment adviser. The claimants said that this delegation was excessive and impermissible.

In dismissing the claim on the facts, the High Court also observed that:

- trustees are required to exercise supervision and control over the strategy and pattern of investments (which the trustees in this case did);
- however, trustees are not required personally to make or to be involved in making each individual investment decision, particularly in light of the potential complexity of investment choices in the 21st century and the number of decisions that are likely to need to be made over a period of several years.

In a pensions law context, it is also worth rehearsing the relevant provisions of the Pensions Act 1995. Most importantly, Section 34 provides that any discretion of trustees to make any investment decision may be delegated to a fund manager (that is, a person who manages the investments held for the purposes of the trust) who is authorised under the Financial Services and Markets Act 2000. Trustees are not responsible for the acts or defaults of any such fund manager if the trustees have taken all reasonable steps to satisfy themselves that the fund manager has the appropriate knowledge and experience for managing the scheme's investments, and is carrying out his work competently and complying with the requirements of Section 36 of the Pensions Act 1995 (which relates to choosing investments).

So, what can we conclude from the legislation and *Daniel v Tee* about the hallmarks of a successful delegation to a fiduciary manager? The following points are key:

- Trustees should think carefully about who should be selected as their fiduciary manager, ensuring as a minimum that their chosen provider has the appropriate knowledge and experience. It may assist trustees to appoint an independent adviser to help with the selection process.
- Trustees should ensure that the respective roles and responsibilities of the trustees, the investment sub-committee (if there is one), the fiduciary manager and any other advisers (for example, any independent adviser appointed to assist in monitoring the fiduciary manager) are clearly defined and understood by all parties. In particular, trustees need to be clear about which investment decisions are being delegated to the fiduciary manager.
- Trustees must retain responsibility for overall investment strategy and risk management, but other investment decisions, such as asset allocation (within agreed ranges), investment manager selection, liability hedging and dynamic risk reduction can be delegated to the fiduciary manager. The extent of the delegation tends to vary from one scheme to the next depending on the trustees' specific requirements.
- Trustees should put in place procedures for regularly reviewing and monitoring their fiduciary manager's performance and compliance with legal requirements. Again, it may be appropriate to appoint an independent adviser to assist in this process.
- Trustees should ensure any potential conflicts of interest are identified and appropriately managed.

Ultimately, responsibility for investment decisions rests with the trustees, but *Daniel v Tee* provides useful recognition from the High Court that it is possible, by applying appropriate controls, to design and implement a successful fiduciary management arrangement.

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[1] [2016] EWHC 1538 Ch