

Delegated Investment Services Part 3: Ongoing Governance and Supervision

As discussed in Parts I and II of this series, a delegated investment services model is one in which key elements of the institutional asset management and governance framework are outsourced to third party providers, along with some of the associated fiduciary responsibilities. The benefits of such a partnership can include more efficient decision-making, enhanced monitoring, and quicker response time to developments in capital markets and/or regulatory changes. Furthermore, it is possible to achieve these efficiency gains at a potentially lower cost.

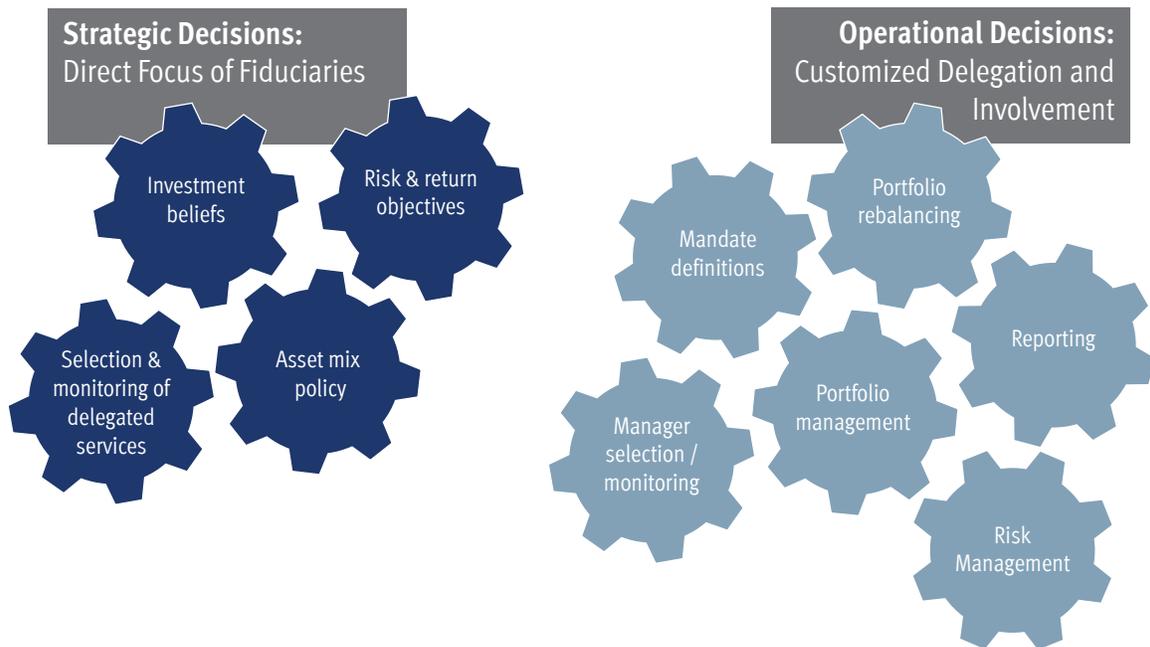
There are various delegated service offerings in the market with different value propositions, and selecting the best fit requires a methodical and rigorous approach based on objective criteria.

Once a delegated service provider has been hired, it is important for the fiduciaries to ensure that the delegated services are fulfilled according to expectations and, if not, to take corrective measures. In this final instalment of our three-part series, we will outline how fiduciaries should approach their ongoing governance roles in a delegated relationship, what they should expect from their provider, and taking remedial actions if necessary.

Managing Expectations

Given that fiduciaries retain overall accountability for outcomes and cannot delegate ownership of the Investment Policy Statement (IPS), they are ultimately accountable for the performance of the chosen delegated service provider. This is true even if the delegated service provider assumes greater fiduciary responsibility related to the services that they carry out in a discretionary fashion. Consequently, engaging a delegated service provider does not eliminate all governance responsibilities of fiduciaries.

Under a delegated service model, fiduciaries can expect to gain the most efficiencies in the Operational areas of the investment governance cycle, such as manager selection for different strategies, portfolio implementation and rebalancing, compliance, and performance analysis. Depending on the extent to which such activities are entrusted to the provider, their day-to-day administration will command much less (if any) of the fiduciaries' attention and energy. Fiduciaries can then turn their focus to Strategic decision-making to set the overall direction and objectives of the asset pool, and ensure that aggregate results are in line with underlying fundamental goals.



Oversight of Delegated Services

To achieve success with a delegated investment services model, it is critical to periodically assess the quality of services delivered in relation to the realized outcomes, as well as to regularly verify that basic activities and functions are being carried out correctly. The list below outlines some of the key deliverables that a delegated provider should be evaluated against. It is important to bear in mind that monitoring is an iterative process that involves balancing short-term results with long-term strategic goals. As such, the requirements and scope of adequate monitoring will look different for each investor and evolve over time.

- **Investment policy advice:** Are fiduciaries being supported with sufficient analysis, research, and advice? Is the support robust enough to enable fiduciaries to make informed decisions regarding the IPS?
- **Investment performance:** Degree to which fund performance and overall portfolio performance are meeting investment targets. Are proactive actions taken to improve or enhance the investment lineup?
- **Asset/fund management execution:** Efficiency and error minimization with regards to rebalancing, compliance, cash flow management, and general portfolio administration.
- **Reporting:** Timely and informative reporting that informs fiduciaries of all pertinent information on delegated activities.
- **Thought leadership:** Bringing new ideas and/or industry knowledge to the advisory relationship to stay ahead of emerging developments.

A rigorous selection process does not guarantee that the chosen service provider will live up to expectations. Shortcomings can be hard to detect in the due diligence stage where the information provided can be somewhat ambiguous in nature, and there is always the possibility that they will fail to deliver on the intended value proposition or provide inadequate services. Even if no major errors or unsatisfactory events occur with an existing provider, the delegated marketplace is always evolving and producing new and potentially superior offerings. Fees are also an important consideration, and should remain competitive and be commensurate with the results delivered. Consequently, it is imperative that fiduciaries continuously monitor the calibre of services provided and devise a system for identifying lapses.

Making Amends

If the chosen delegated investment services provider is producing subpar results and/or making mistakes to the point of jeopardizing outcomes for asset beneficiaries, then fiduciaries are obliged to take action. There are several means of redress fiduciaries can employ:

- Work with the provider to conduct an in-depth analysis of why they are not meeting investment and/or servicing objectives, with the goal of identifying opportunities to resolve the situation.
- If an internal resolution cannot be reached, another option is to seek the advice of an independent consultant who has expertise in this area but does not offer delegated services. They can provide a third-party opinion and work with both sides to discover what the underlying issues are and how to address them.
- In the event that both of the above options prove ineffective, the next step would be to return to the market and restart the Request for Proposal process to search for a new provider.

Regardless of the actions taken, the remedial process should focus on what went wrong in the most recent experience and use that information to develop a concrete set of criteria and outcome-oriented goals that reflect the fiduciaries' needs and will inform future decisions. This will allow both parties to gain valuable insight and increase the fiduciary's chances of a better experience.

A Delegated Future

The increasing prevalence of delegated investment service models can be attributed to multiple factors, but irrespective of the rationale, the model is here to stay. For many fiduciaries, outsourcing operational investment management functions to a capable and well-resourced provider is a logical step forward. If executed properly, the arrangement can yield considerable operational and financial benefits that would have been difficult to achieve otherwise.

That said, engaging an external party and entrusting them with beneficiary assets will inevitably present its own set of challenges. Therefore, it is important to thoroughly understand the model, determine if it is indeed the right choice, then use an objective and methodical process to select and, subsequently, govern the delegated relationship.

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