Under the microscope

Padràig Floyd analyses the influence of fiduciary management on the pensions market and the levels of scrutiny it is undergoing

Summary

- Fiduciary management has seen considerable growth over the last five years.
- In 2013, nearly nine in every 10 mandates (88 per cent) were smaller than £250 million. However larger-sized mandates to fiduciary managers are increasing.
- The use of fiduciary management among schemes had increased to 46 per cent in 2015 – up from 18 per cent in 2011 and 37 per cent in 2014.
- The last couple of years have seen considerable growth of third-party providers that help schemes to select and appoint a fiduciary manager.
- While the funding level is a crucial indicator of performance on an individual scheme basis, it is very difficult to use that as the basis of a way of differentiating between providers.
- Trustees must be absolutely clear on the scope of the contract, any benchmarks to be used and the objectives of the scheme if they are to hope to be able to measure performance.

The investment industry has been a source of innovative strategies and services to meet the ever-changing needs of UK pension funds and fiduciary management is one such service that has seen considerable growth over the last five years.

Referred to by a number of different names, they are all doing the same thing. That is, the outsourcing of all or a portion of the pension fund investment portfolio to a third-party investment manager who will manage it within agreed parameters, but with the discretion to make day-to-day management changes.

Continental influence

It's a relatively simple concept that has been used in other countries – notably the Netherlands, where it has gone from a nought to £100 billion market in a short number of years.

Until recently, fiduciary management was largely the preserve of small schemes who simply do not have the resources to maintain the levels of governance that large well-resourced schemes can.

In 2013, nearly nine in every 10 mandates (88 per cent) were smaller than £250 million, but as the size of scheme awarding fiduciary mandates is increasing, so too is the size of the mandates, according to the *2015 KPMG Fiduciary Management Market Survey*, released in December.

This is confirmed by Aon's report released in September, which found that take-up rates among schemes had increased to 46 per cent in 2015 – up from 18 per cent in 2011 and 37 per cent in 2014, largely through a fully outsourced arrangement.

Among schemes of more than £1 billion in assets, more than half (51 per cent) were using full or partial fiduciary management. The KPMG study shows growth has topped £102 billion of assets under management with one out of 10 schemes using some form of fiduciary management.

KPMG believes the distinction between full and partial fiduciary is important – as do many fiduciary managers. They tend to argue that a partial mandate is no different from a mandate with a specialist manager. In many cases, these mandates have been for very specific market sectors or strategies the schemes awarding them feel unwilling or unable to manage within their risk or governance budgets.

Not all fiduciary managers are equal

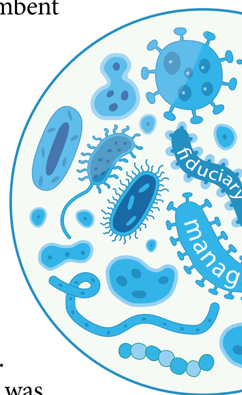
In addition to the difference between types of mandate, there are differences between those offering these services.

While there are specialists and asset managers who compete in the market, it is the consultants who continue to dominate this market.

They have the most mandates and in the early days of adoption, they were the number one choice for schemes. The reason for this is simple – the investment consultant has a special relationship based on trust and once there was a fiduciary management service available, schemes saw it as a natural extension of what they were already doing.

This is particularly true for those who would adopt a consultant's 'best ideas' – their appointment would greatly simplify the work of the trustees by handing over the daily control to the consultant.

However, this is where the dissent began. How could the incumbent investment consultant – in good conscience – take on a scheme client without a tender process? This is a basic tenet of governance for the appointment of a single pooled fund manager, yet was not happening with the outsourcing of a scheme's assets lock, stock and barrel.



As recently as 2014, this was typical, with 75 per cent of mandates bypassing a tender process, according to KPMG's survey, though some of the larger fiduciary managers dismissed this figure.

Willis Towers Watson head of the

delegated business Pieter Steyn says he does not recognise such a pattern. "After a fund has decided it wants to do fiduciary management, almost without fail it will consider the wider market, often engaging a third party," he comments.

Independent scrutiny

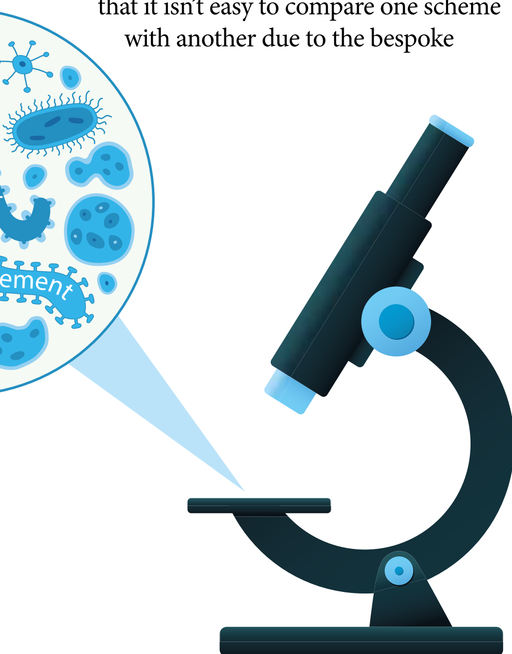
The last couple of years has seen considerable growth of this third party provider Steyn refers to that assists schemes select and appoint a fiduciary manager. Often they will go on to monitor their performance.

These are generally investment consultant firms who have rejected fiduciary management as a business model. However, their use is not widespread, with the KPMG survey showing that only 23 per cent of new appointments this year were advised by an independent third party.

PiRho Consulting director Phil Irvine says once a consultant becomes a provider, they are in control of all the knowledge and obvious conflicts will be apparent.

"Knowledge is power," says Irvine, "and if you're in control of presenting that knowledge, that is a very powerful position to be in."

The problem with performance is that it isn't easy to compare one scheme with another due to the bespoke nature of fiduciary mandates. But for Buck Consultants investment consultant Willian Parry, "funding level remains the best metric to demonstrate that the manager is doing what they are expected to be doing".



Parry admits that while the funding level is a crucial indicator of performance on an individual scheme basis, it is very difficult to use that as the basis of a way of differentiating between providers. It can't show the client how much of that is simply momentum in the market rather than manager's skill.

A comparative index or table also doesn't allow for the amount of discretion a fiduciary manager may have, P-Solve investment solutions managing director Barbara Saunders states. Two similar mandates can be very different if one of the managers has very little discretion over how to run specific areas of the portfolio.

That said, Saunders doesn't accept that fiduciary managers can't do more to demonstrate the value they are adding for clients: "It should be possible for them to show what they have achieved in running the growth assets," she says.

Though Saunders accepts the criticism that there are conflicts within the fiduciary management relationship, she utterly rejects the notion that an outside party can magic them away.

"Traditional consultants are equally conflicted," says Saunders. "Those that do not offer fiduciary management, while they offer monitoring services, cannot recommend it as an alternative for their clients without accepting they could lose that client's business."

Not all believers

Despite the growth of fiduciary management, a study from Hymans Robertson show that 90 per cent of independent trustees believe 'independent' consultants – ie those who consider themselves 'unconflicted' by offering fiduciary management – provide better advice that is more aligned with the schemes' interests.

This has to be taken within the context of better value, as 59 per cent believe fiduciary services to be more expensive.

Hymans Robertson partner Calum Cooper says the figures prove that fiduciary management comes with a hefty price tag and conflicts.

"On the surface, delegation may appear to reduce trustees' workload but it also means an extra layer of scrutiny is required to monitor the fiduciary manager," says Cooper.

"To put it another way, delegating doesn't remove work and risk; it simply changes its nature. Those with fiduciary managers in place often appoint other investment consultants to oversee their activities."

Good governance is best practice

Whichever way you lean on the issue of conflicts, the best way of dealing with them is to ensure you undertake proper and full due diligence, Sackers partner in the finance and investment group Ian Cormican states.

It is important for trustees to remember that a fiduciary manager has no overriding fiduciary duties or obligations beyond those set out in the contract between them and the trustees, says Cormican.

He advises all trustees ensure they follow the due process of selecting a provider and pin down any potential conflicts of interest and understand how they will be managed.

Next, trustees must be absolutely clear on the scope of the contract, any benchmarks to be used and the objectives of the scheme if they are to hope to be able to measure performance.

"Finally, understand this is just a contract, like any other," adds Cormican. "There is nothing magical about the word 'fiduciary', and you will only get out of the arrangement what you put in."

Written by Padràig Floyd, a freelance journalist