Down but not out?

As fiduciary managers face falling levels of assets under management, Gill Wadsworth considers the pressures facing the sector and where it may find new opportunities to diversify

Summary
- Fiduciary assets under management are in decline for the second year running, while the number of new mandates has stalled.
- The sector faces increasingly high levels of competition while fees are under pressure.
- Opportunities exist to diversify and evolve but the industry faces an uncertain future.

As fiscal fallouts go, the one following the September 2022 'mini-Budget' has been particularly memorable.

Well over a year later and the impact of the ensuing gilts crisis still reverberates around select corners of the UK pension industry, with some sectors being forced to rethink how they will operate in future.

Among those most affected are fiduciary managers (FM), many of whom relied on liability-driven investment (LDI) strategies as the bedrock of prudent pensions management. These took a well-publicised battering as gilt yields rose dramatically, with a corresponding fall in the value of UK defined benefit (DB) scheme liabilities forcing FMs to

scramble for capital to maintain liability hedging targets.

But, as Isio's *Latest trends in Fiduciary Management 2023* report notes, "faced *[with]* the challenge of liquidity, they weren't always successful".

The report adds: "This unprecedented *[gilts crisis]* had a large-scale impact on the industry, arguably changing it forever. As all UK pension schemes faced investment challenges from this backdrop, how FM both helped and hindered has been a key theme of 2023."

One of those large-scale impacts is painfully evidenced in the second straight year of falling assets under management (AUM). Isio reports that total AUM for full FM mandates have declined from £113 billion in 2022 to £105 billion in 2023. For partial mandates the decline is £22 billion over the year with AUM now standing at £82 billion.

Fee pressure

This presents a genuine issue for those FMs that base their fee structures on the amount of assets they hold, making it no surprise that the Isio report reveals a trend towards alternative charging structures.

While 88 per cent of fiduciary managers still link fees to AUM, there has been a significant move to a tiered fee where charges change with asset size, and to fixed fees with performance element.

Cardano partner and co-head of clients, Patrick Cunningham, says not only are FMs feeling fee pressures as a result of diminishing AUM, but they are also in a more competitive market with a greater number of players and the strategies they oversee are less focused on growth and so liable for lower fees.

"We are feeling fee pressure, but we've felt that in each of the past five years; it's not just since the gilt crisis. It is a very competitive market with a significant increase in the number of firms – perhaps 15 – offering fiduciary management."

Cunningham adds: "The fees we can charge on smaller and lower risk portfolios is below what's chargeable for managing an equity portfolio. For all those reasons, FM fees have continued to come down."

Corresponding with the increase in FM players, third-party evaluators (TPEs) that assist schemes in assessing the market and making provider selections are shaking up the market.

IC Select UK's *Fiduciary Management Market Survey,* published in September 2023, reports 66 per cent of schemes used a TPE to assist them in the selection of a FM in 2022; a reduction of 9 per cent from the previous year.

Meanwhile, Isio finds that 80 per cent of FM mandate wins over 2023 used a TPE for the selection exercise. The influence of TPAs in addition to the 2019 Competition & Markets Authority Fiduciary Management Review has, according to Isio partner Paula Champion, added further competitive pressure on the market.

"Retender activity prompted by the CMA review has resulted in a genuinely more competitive landscape – with greater engagement and innovation from FMs, a downward trend in fees, and an increase in the involvement of TPEs."

Champion adds: "Where we have seen schemes retender their mandates, this has been an opportunity to ensure that the fiduciary approach is aligned to the schemes' objectives, and that the philosophy and style of a particular FM is consistent with the trustees' beliefs and preferences. In most cases, where the FM is retained, the retender process has been clearly positive with a focus on refining reporting or servicing to better support to the trustees' needs."

Stalling mandates

Alongside a decline in AUM thanks to the gilt crisis, there is also evidence that fewer schemes are adopting the fiduciary management model.

For the first time since Isio started surveying the market, growth in the number of fully delegated mandates has stalled, with the number of full mandates increasing by just 3 per cent while partial mandates have declined by 13 per cent.

Capital Cranfield professional trustee, Paul Watson, suggests the market is at saturation point.

"Many schemes moved from advisory to FM over the past 15 years, but I can't see there are many other schemes to move to FM if they haven't already. There used to be an argument that smaller schemes could be attracted to FM services – subject to the minimum fee – but if those schemes had low or no LDI they now find themselves fully funded on a buyout basis so leapfrogged the need for FM."

Meanwhile, IC Select director, Roger Brown, argues the falloff in mandates is a direct result of the CMA review, which has prohibited investment consultancies from converting advisory clients into FM business without participating in a beauty parade involving at least three other potential providers.

"Prior to 2019 investment consultants would be pushing hard for schemes to switch to fiduciary management but now there is a risk that they might lose the business following a competitive tender. Suddenly, I think the incentive to move those schemes is considerably less."

That the DB sector – which is the fiduciary manager's bread and butter – is shrinking can only add to the challenges already facing providers.

Champion suggests diversifying client bases to incorporate other long-term assets, such as those from defined contribution schemes or charities.

Elsewhere, alternative variations of FM may offer some respite. The outsourced chief investment officer

(OCIO) model has been adopted by several multi-million-pound schemes including British Airways, BAE Systems, Royal Mail, Centrica, National Grid and Kier.

But Brown warns the OCIO market is limited.

"These are typically very specific mandates involving multi-billion-pound schemes that are close to buyout. They have in-house expertise in running growth assets, but they need people to run bond mandates. Entire investment teams are moved over to the fiduciary manager which has vast global resources to help them move to buyout," he says.

New opportunities

Where there is more potential, according to Cunningham, is in servicing the corporate sole trustee markets, which Hymans Robertson reveals now account for around a third of professional trustee appointments, having increased by 12 per cent in the year to March 2023.

Cunningham says: "The largest four or five professional trustee firms probably have 60 per cent or more of all appointments. Many of those firms have been bought in whole or in part by private equity firms that are hoping to see growth in revenue and profit. Where those trustee firms are acting as a corporate sole trustee, there will be an incentive to centralise and scale some of the services they provide, and a lot of them are turning to FM."

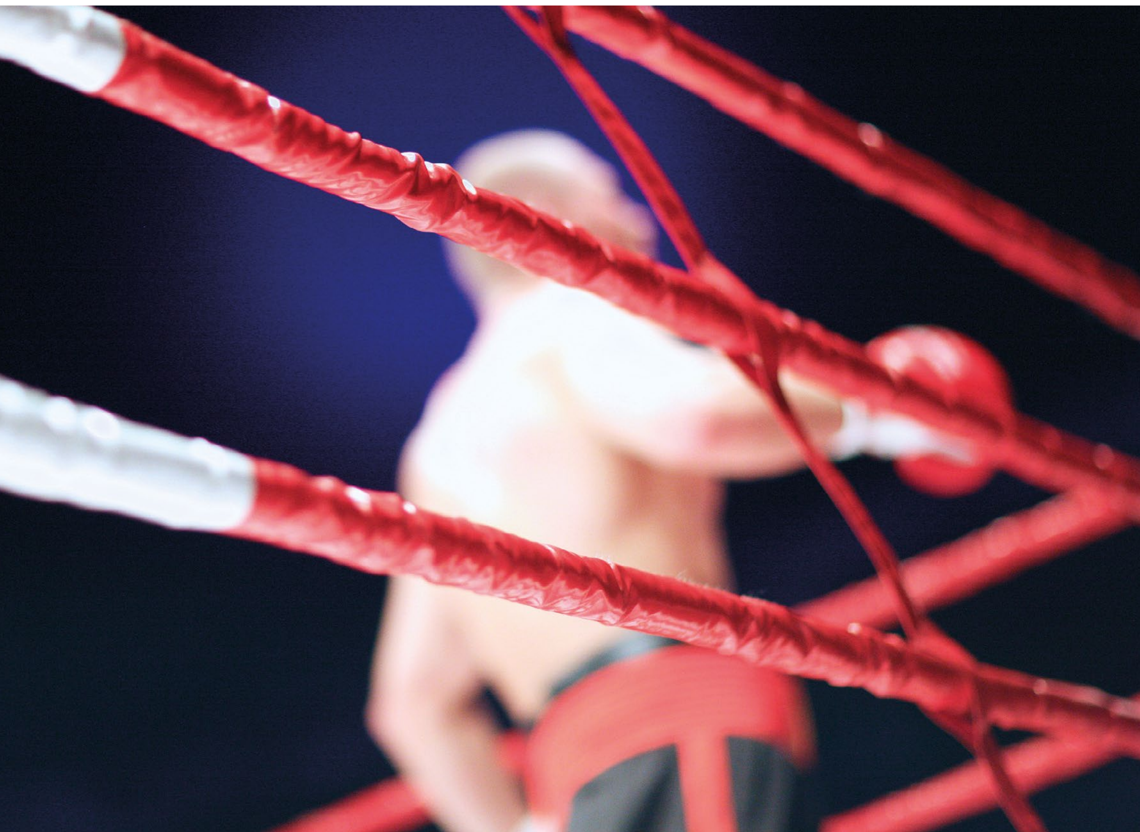
> **"Not only are FMs feeling fee pressures as a result of diminishing AUM, but they are also in a more competitive market"**

He continues: "I don't think any professional trustee firm will end up with a formal FM partner, but it might make sense to have some pre-vetted and pre-negotiated building blocks, rather than start from scratch and do something different for every scheme."

However, Watson says the preferred provider model is "certainly not the approach that we adopt", but adds: "On the positive side, there may be value in reduced fees for schemes and an efficiency in corporate sole trustee governance costs, given the consistency of approach, which should be passed through as lower fees."

But Watson notes he would be concerned that one size does not fit all.

"Scheme requirements can differ based on circumstances, and FM providers have certain attributes that mean they may or may not be suited to that client. They may differ in ESG criteria, fee structures, segregated or pooled LDI. As a professional trustee, I would always want to do a whole of market review to find the best fit for the client situation, and the CMA objectives require that at least three FMs are considered."



Whether the FM sector is in terminal decline depends on its ability to adapt to the fallout from the LDI crisis and the changing needs of its dominant client base. Fiduciary managers have shown resilience and a willingness to innovate and evolve, but, in an increasingly competitive market where fees are forever being squeezed, their future currently looks uncertain.

Written by Gill Wadsworth, a freelance journalist