Summary
• Despite regulatory, financial and economic turmoil, including the effects of the September 2022 LDI crisis, use of fiduciary management (FM) among UK DB schemes has increased in recent years.
• Factors contributing to adoption of FM include additional burdens on trustees and increased use of sole corporate trustees.
• Use of the Outsourced Chief Investment Officer (OCIO) model of FM is also increasing among larger schemes.
• It is not yet clear what the long-term effects of the LDI crisis on the evolution and uptake of FM services will be, but regulatory guidance related to selection of managers, long-term objectives for schemes and ESG are all likely to help shape the future of this market.

Fiduciary beauty

Amid the turmoil of 2022 and the growing regulatory burden on trustees, fiduciary management services for DB schemes continue to evolve. David Adams tracks developments in a growing and changing market

If fiduciary management (FM) for DB schemes did not exist, someone would have to invent it. For many schemes the FM concept offers many advantages as a means of supporting trustees facing ever more complex investment strategies and regulatory requirements as they try to guide schemes towards long-term objectives.

One key benefit is that FM can be adapted to suit a scheme's needs and circumstances. There is room for huge variation within the basic concept of delegating some or all day-to-day investment decision making and operations to a fiduciary manager, while trustees retain control over high level strategy.

Cardano partner and co-head of clients, Patrick Cunningham, believes the increased use of sole corporate trustees by many DB schemes has helped encourage use of FM. "Many sole trustees have decided that fiduciary management is effective and efficient when combined with a sole trustee model," he says. Meanwhile, more larger schemes are using the Outsourced Chief Investment Officer (OCIO) model of FM, which can offer even greater flexibility.

Isio's most recent *Latest Trends in Fiduciary Management* survey, published in November 2022, showed growth of the FM market in 2022, despite political and economic turmoil. Eighteen per cent of UK DB schemes now use some form of FM. But, while total mandates grew by 7 per cent compared to 2021, total AUM fell by 5 per cent, to £218 billion, the first fall since the 2008 financial crisis.

Years of turmoil

It has been an eventful few years in this market, beginning with a 2019 Competition and Markets Authority (CMA) intervention, compelling schemes that had commissioned a fiduciary manager without conducting a competitive tender to retender.
More than three quarters (78 per cent) of schemes that had done this by the end of June 2021 stayed with an existing fiduciary manager, but Van Lanschot Kempen UK managing director, Andre Keijsers, thinks the process opened some trustees' eyes to the way the FM market was evolving.

"Services had moved on," he says. "There was more transparency, more reporting, and alternative asset classes had become more prevalent."

However, market growth and evolution was then disrupted by the pandemic, by rises in inflation and interest rates during 2022, followed by the LDI crisis in September. Trustees using an advisory model, rather than FM, would have regretted a lack of delegation during this period. "They would be spending all day and most of the evening signing letters of instruction," Keijsers recalls. "On the FM side, things would have been easier because there was more discretion *[for the fiduciary manager to act]*, but there was a broad range *[of performance]*."

Indeed, recent research from Schroders and the Pensions Management Institute (PMI) shows that although 48 per cent of the schemes surveyed that were using FM agreed that their investment governance model provided the support needed during the crisis, 52 per cent said there was "room for improvement".

One factor that helped define managers' performance was whether they were relying on third parties' pooled funds to manage LDI, or were managing LDI internally on a segregated basis. Those in the former camp were in a more difficult position, as some pooled funds ran into difficulties.

Some of the schemes affected by the pooled funds issue may since have persuaded fiduciary managers to use a segregated LDI arrangement, according to Cunningham.

One important consequence of the crisis, says PwC head of fiduciary management, Keira-Marie Ramnath, is that many fiduciary managers have improved the way they pass information to trustees.

"The main area of change now is around transparency and communication," she says. "Even if you look at some of the liability hedge reporting fiduciary managers put out, it's never been that detailed, so you have to ask a lot of questions. Now you're seeing things in those reports that wouldn't have been included before."

Regulatory concerns

Another effect of the movement in gilts during Q4 2022 is that many schemes' funding levels have improved dramatically. However, as Aon associate partner, William Parry, explains, this has not necessarily had a predictable impact on strategy.

"You've had schemes getting better funding levels – but they're not actually close to buyout," he explains. "Some may still be open, or may have more younger members. That's changed the way people think about their endgame."

At the same time, Parry notes, The Pensions Regulator has "slightly softened" guidance around long-term objectives. "Its wording has been less about necessarily targeting buyout, as opposed to having a plan when you get to a suitably de-risked state," he explains. "The softening of that wording is significant. People are looking at whether they can run the scheme for longer."

Parry says fiduciary managers are now focused on helping schemes during a period of heightened financial and economic volatility. Isio's November 2022 suggests many fiduciary managers have tried to reduce risk using two main methods: Increasing use of LDI; and diversifying asset allocations away from equities.

It may be too early to draw firm conclusions about the longer-term effects of the crisis. IC Select head of research, Anne-Marie Gillon, says the company will publish a new FM market report within the next few months incorporating analysis of 2022 data, but that this data is unlikely to capture the full impact of the crisis.

Even so, it appears that the events of the past two years have both helped to reshape some FM services and to increase the willingness of more trustees to consider using those services.

"More schemes are thinking about FM and OCIO," says Parry. He reports "more demand for OCIO than we've ever seen" among larger schemes. Isio's findings also suggest that more schemes of different sizes are using FM, including those with AUM below £100 million and larger schemes, some of which may be using OCIO.

Recently updated guidance from The Pensions Regulator on selecting a fiduciary manager emphasises the need for trustees to understand the differences between fiduciary managers' approaches to elements of FM including portfolio construction, risk management, holding structures, levels of delegation and ESG. It highlights the need to identify and mitigate potential conflicts of interest related to investment consultants and other advisers already working with the scheme.

It also suggests schemes consider appointing an independent consultant or intermediary to advise on structuring the mandate, selection of the fiduciary manager; and to assist "ongoing monitoring and evaluation of the fiduciary manager's performance".

IC Select's 2021 *Fiduciary Manager Survey* found that only 31 per cent of schemes using FM had commissioned this kind of independent oversight.

While Gillon is unable to say at the time of writing how this figure has changed since, she says: "Our view is that the oversight of fiduciary managers still needs to move forward."

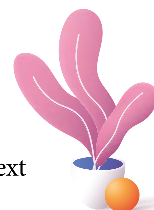
The future for fiduciary management

Another factor likely to influence future development of the FM market is the sustainability/ESG agenda. Isio found that 70 per cent of fiduciaries could provide key Task Force for Climate-Related Disclosures (TCFD) metrics for fully delegated schemes. TCFD reporting requirements, at present only mandatory for schemes with more than £1 billion AUM, are expected to apply to all schemes at some stage. Isio suggests the need to comply with these requirements may encourage more smaller schemes to consider using FM.

PwC head of investment strategy, Sam Seadon, thinks more corporates are now taking a closer interest in the way the DB schemes they sponsor are run: "Because the deficits have got smaller and you're talking about surpluses rather than deficits." This could translate into employers encouraging trustees to work with fiduciary managers.

All things considered, it seems likely that use of FM will continue to grow. "I think more schemes and sponsors will appoint professional trustees, sole trustees and fiduciary managers, because the role of the trustee has become and will continue to become really difficult," says Cunningham.

"It's not for every scheme," Gillon warns. "You need to think very carefully about what you want to do. If a trustee board comes to us and says they want to move to fiduciary management, we say, let's talk about fiduciary management versus advisory – let's make sure they understand the implications of the decision." But even if it is not always the right choice, FM will surely play an important role in the next chapter of the DB story.



Written by David Adams, a freelance journalist

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