
# The power to pivot

**Tim Banks explores how fiduciary management can provide pension schemes with the flexibility they need during their journey plan**

These are demanding times for pension scheme trustees and sponsoring companies. Regulatory demands are increasing and requirements are ever-more complex.

Britain has about 5,500 defined benefit (DB) schemes – a large number by international standards. Regulators are asking trustees and sponsors to consider ways to improve efficiency.

Consolidation – what form and how to get there – is on the minds of decision makers. But consolidation is often presented as a hard choice between keeping things as they are and arriving at a buyout. This sees the consolidation journey as a two-stage process: set a strategy to invest in higher return assets and then switch into safer assets when you are close to full funding.

Whatever the ultimate objectives of a scheme are, it may take 5, 10, 15 years or more to get there. That's a long time in which plenty can happen – as we know from our personal lives. Fiduciary management offers a flexible alternative to the all-or-nothing consolidation narrative.

Combining traditional advice on strategy with a mandate to implement can be a powerful combination. It also treats the scheme's journey as a gradual one with several different stages and mindsets and the need to respond when circumstances change.

We see more and more trustees turning to fiduciary management to give them the flexibility and expertise they need. The number of schemes to adopt this approach had increased from about 60 in 2008 to almost 900 in late 2018.

An important feature of fiduciary management is the ability to pivot when things change. Instead of setting a strategy and reviewing options occasionally under a traditional advisory model, the scheme entrusts industry experts to manage proactively and respond to changes.

Politics, regulation and markets always have the potential to throw up the unexpected but in a 24-hour world where established ideas are under fire and pensions are increasingly political, events are arguably moving faster and becoming less predictable.

For example, in the run up to the Brexit vote in June 2016 it was clear that if there was a leave vote the pound would suffer and that if there was a vote to remain there would be little effect on sterling.

How many schemes run on traditional lines were able to put in place currency hedges to help protect

against the pound's sharp decline after the referendum result? A good fiduciary manager would not have had any special knowledge but it would have had the responsibility and flexibility to make that pivot after analysing the likely scenarios.

More recently the government announced it would make changes to the Retail Price Index (RPI) over the next decade to align the measure of inflation with the Consumer Price Index, which usually runs about a percentage point lower than RPI. This change has implications for the valuation of schemes' assets and liabilities linked to RPI.

Again, an expert fiduciary manager would have acted promptly to identify which clients' liabilities had big exposures to RPI and put in place de-risking triggers to help preserve the value of members' pensions. As with the Brexit example it's the mandate to monitor and that ability to pivot that enables fiduciary managers to do this.

Under a traditional advisory arrangement there would have been less flexibility and ability to react than under fiduciary management. That shouldn't be surprising. It's simply not reasonable to expect busy scheme trustees to have the time and insight to spot these kinds of dangers and opportunities to lock in value.

Trustees are facing increasing demands and their jobs aren't getting any easier. The regulator wants schemes to show evidence of journey planning towards an intended destination and a strategy linked to a long-term funding target. Expect the regulator to ask trustees for more evidence to demonstrate how the investment strategy speaks to the funding target, including an audit trail.

We still come across large schemes with no journey plan but even the better-prepared schemes may struggle to adapt to the additional demands coming down the track. It's very difficult for trustees to react quickly in a coordinated fashion when circumstances change – or even to stay abreast of developments.

On that journey from where we are now to buyout or self-sufficiency, markets, ideas, and options can alter with an impact on the funding plan and investment strategy. Most of this discussion focuses on assets – but liabilities can be unpredictable too. A stark example is the government's introduction of freedom of choice, which has triggered £30 billion of withdrawals in little more than four years.

Overlay these changes and disruptions with the different stages in that journey of five, 10, 15 or more years and you have a complex set of dynamics that the traditional model, with its three-year reviews, can struggle to track. Professional managers whose job is to keep up with developments in real time can have that ability to pivot and proactively manage liabilities and assets.

There has been a lot of discussion in the market recently about cashflow-driven investment (CDI). Like fiduciary management, CDI isn't new. It means managing like an insurer and is consistent with getting to the journey destination, whether that is self-sufficiency or a buyout.

About 10 per cent of our client schemes in fiduciary management are managed according to CDI and all of them are gliding towards that basis. The flexibility of fiduciary management is much better suited to managing assets proactively against liabilities for a successful CDI strategy.

Consolidation is a big move, and for scheme sponsors and trustees, fiduciary management can act as a first step in the world of consolidation. We recently lost our fourth client to a buyout but of course it wasn't really a loss – the client got to their destination and our job was done.

Fiduciary management won't be for everyone. There's a cost involved, of course, and many schemes may prefer to stay with their current arrangements. But as I write we are heading for an unpredictable general election that could produce wildly different outcomes and Brexit is still unresolved.

It doesn't feel like the world is going to get any more predictable soon and pension schemes will continue to face demands and changes. In that environment the power to pivot could prove vital.

**Written by Mercer principal, Tim Banks**