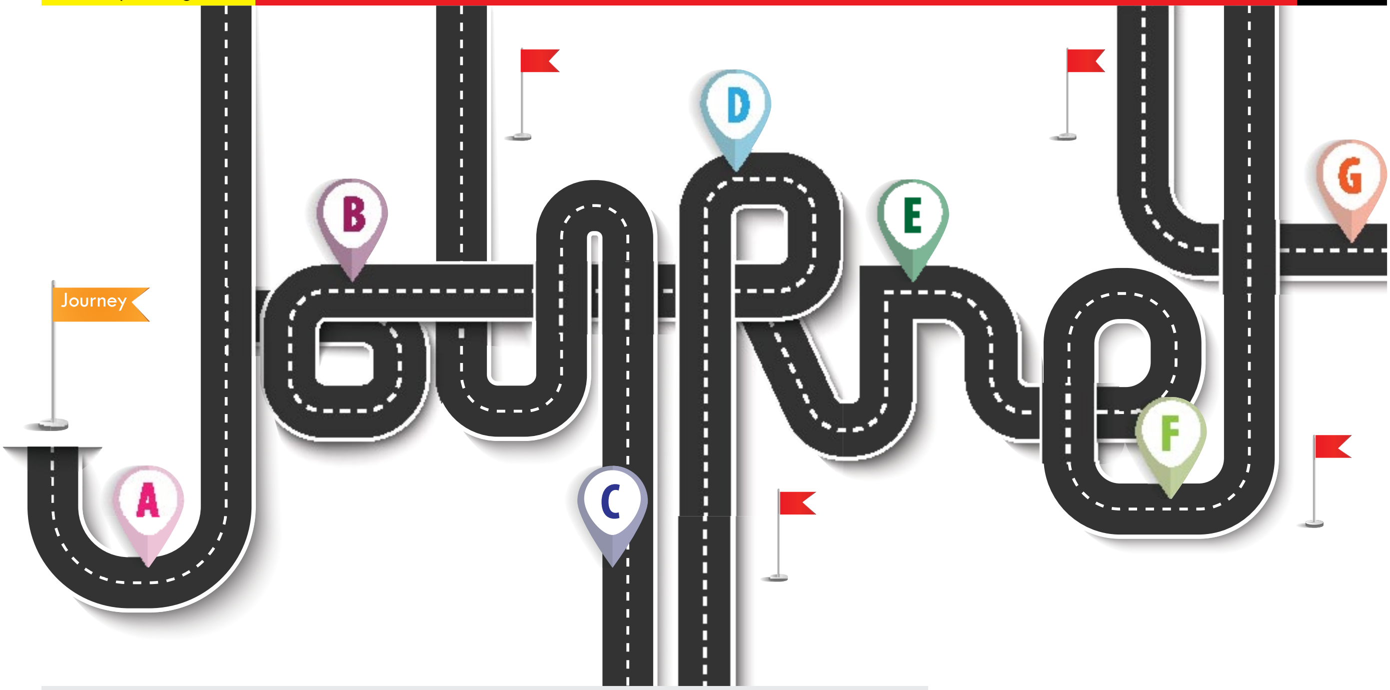

Summary
• In mid-2019, it was decreed that fiduciary management services now have to go out to tender.
• As part of the tendering process, trustees should plan ahead, and look at the capabilities of the fiduciary manager and their track record.

Going on a journey

Pete Carvill explores the journey of selecting a fiduciary manager

As the year closes and the cold, dark nights come in, it is the opportune moment to look back on one driving issue in the fiduciary management space: the Competition and Market Authority's (CMA) June publication of its final remedies.

There has been something of a long and winding road to get to this point, but it is instructive to take a step back and look briefly at the role of a fiduciary manager. Ernst & Young has a good, if slightly wordy, definition of what one is and does.

According to the organisation, fiduciary management is "[…] an investment governance solution that involves the trustees delegating certain elements of the investment process to an investment expert – the fiduciary manager".

The fiduciary manager, says Ernst & Young, "[…] can be expected to employ the best practices in pension scheme investment management. This means managing the pension assets relative to the liabilities, employing techniques such as hedging interest and inflation risks, maximising investment diversification and de-risking as market conditions allow."

Trustees approach fiduciary managers for a number of reasons. BlackRock head of UK fiduciary, Sion Cole, says that there are three types of clients. "One, they're underfunded, which is a common driver. Two, they are in a better position and it's about investing in something that delivers cashflows. And, three, there are those that are looking to transfer to an insurer," he explains.

The CMA's work in this area began in September 2017, following a referral from the Financial Conduct Authority. This led to a December 2018 report finding an adverse effect on competition in the fiduciary management and investment consultancy markets. The report made clear a number of changes, with a December 2019 date for implementation.

The key changes

The key change being implemented revolves around tendering. The Pensions Regulator outlines it this way: "From 10 December 2019, trustees will be required to run a competitive tender exercise for any agreement with a fiduciary manager provider that would result in 20 per cent or more of scheme assets being delegated. Trustees who appointed a provider prior to 10 June 2019 without conducting a competitive tender process will be required to conduct a competitive tender process within five years after the first appointment of a fiduciary management services provider. Where the five-year period expires before, on or within two years of 10 June 2019, trustees must complete a competitive tender no later than 9 June 2021."

Pensions Age approached a number of people in the market. The responses were broadly supportive of the work being done. CEM Benchmarking principal, John Simmonds, says that everything put forward "made sense". He adds: "There were inherent conflicts in the system and far too many consultants were leading clients down a path that resulted in the consultants becoming the fiduciary managers. We needed to change that and introduce some proper competition into the industry. But it is difficult to force an organisation to go through a tender and have regulatory oversight that makes it a truly competitive process."

Mercer UK head of fiduciary management, Ben Gunnee, went further. He says: "The regulators wanted to see that performances are transparent, so trustees can compare one fiduciary manager with another on things like fees and past performance. Some produce fees in differing ways, whereas some had bundled fees, and so it often wasn't clear or easy to make comparisons. The overall report and its aims were pretty sensible."

Of those interviewed, there were comments that making funds go to tender would mean increased competition in a market long dominated by a handful of big players. This, it was said, would not only bring smaller players in and give them a chance to show their value, but would encourage trustees to see that they have more choice.

"It gives trustees the opportunity to go back and think about their investment philosophy, and to re-think about what they are trying to achieve from an investment risk perspective," Ernst & Young director Rikhav Shah says.

Bringing in fiduciary management

There are a number of things that trustees should do when looking to bring in a fiduciary manager. Broadly speaking, there are three areas. These are the objectives of a scheme, the capabilities of the fiduciary manager, and their track record.

The most important step comes at the beginning when trustees should look at and define what it is that they want to achieve. Simmonds says: "If you're a DB scheme and you're looking at an exit strategy, you should be considering what your path to buyout is. And what you need there is for your fiduciary manager to help you make better decisions, particularly around things such as funding and timing."

Gunnee goes further, saying: "Fiduciary management 101 was something that people either took, or didn't. It's rapidly evolved into a solutions business, even if that's a terminology that's somewhat overused. Good fiduciary managers can do different things, depending on the client. Whereas some clients give autonomy around things such as asset allocation decisions, hedging, and de-risking, some delegate some of these. It's been an evolution of the market."

This planning should go back further than implementation, according to Cole. He says that many trustees make the mistake of not sharing their information upfront and will ask instead for the fiduciary manager's best portfolio. "That's akin," he says, "to asking a builder to build a house. You might get a mansion, a two-up-two-down, or a tent. The question has been answered, but in a different way because not enough information has been shared upfront. If you do that here, you'll get a range of solutions but they won't meet your needs."

Next to consider is the capabilities of the fiduciary manager. Gunnee says that trustees should look at the portfolio management capacity and assess whether the fiduciary manager's is strong enough to meet their needs. Many of these organisations, he says, only have 10 people working there. "Given that you need experience in many, many areas, that number is not going to cut it."

Aon's head of investment for UK and Ireland, Tim Giles, offers a more-granular vision. He says that trustees and schemes should be asking themselves if the fiduciary manager is someone that they can work with, and for some time. "Will they be able to evolve?" he says. "Most of the discussions in this area are around DB schemes, but how will that change around areas such as de-risking? You may want people, in the long-term, who have that capability."

The third area is around the preparations that should be made by trustees, which is considering the track record of the fiduciary manager. Giles says that trustees should not look only at what has been done, but how they have done it, and the composition of the portfolio. "You want to see that the firm's track record is consistent with the process to give you the right returns for your scenario. There's no point in having great returns from the previous year if too much risk is being carried."

Growth market

Despite a reported dip as people waited to see what the CMA came back with – "the number of mandates has been slow this year as trustees have waited to find out what's going on", Gunnee says – the market remains a growth one. This is largely due to complexity of what's going on beneath the surface when it comes to DB scheme investment. Cole says: "The entire UK DB landscape has assets of around £1.6-1.7 trillion. It's not a market that's growing significantly. But there's a lot of activity – big movements from assets to growth to defensive positions, and things like alternative assets. When you bring that together, it's a complex position and it's driving the market."

Written by Pete Carvill, a freelance journalist