Summary
- Delegation can help trustees take back control.
- Investment opportunities can be upskilled through fiduciary management.
- How will fiduciary management cope with a no-deal Brexit?

Fiduciary management comes of age

Having now become established within the UK pensions market, Elizabeth Pfeuti considers how fiduciary management will fare under challenging investment market conditions

Once the new kid on the finance block, fiduciary management is coming of age.

With £142 billion across 862 UK mandates in 2018, according to KPMG, the amount of assets has grown by more than 1,080 per cent in the past 10 years.

Small wonder, then, that the UK's largest asset managers have set their sights on competing at the highest level in this sector, while the world's leading investment consultants restructure to focus on fiduciary assets.

The approach has also – eventually – been given the green light by the competition regulator, which has put into place new strict standards on performance reporting and fee disclosure.

But with trade wars on the horizon and a potential no-deal Brexit, can this newly maturing approach to pension fund investment perform under pressure?

For Schroders fiduciary manager, Rosalind Scott-Douglas, the key to the approach's success – in good times and bad – is how it strengthens pension fund governance.

"It works in parallel with other corporate structures, such as the board, which look at risks, take a general overview then delegate the details and implementation of projects on a day-to-day basis," says Scott-Douglas.

Time to call in the experts

Over the past 15 years, schemes have recognised that most trustees are not investment experts, but even if they were, being allowed just one meeting a quarter to discuss all elements of running a pension scheme, alongside their day job, was not the optimum process for most schemes.

"If you're getting good advice, it should be combined with the best implementation," says Mercer head of fiduciary management (UK) Ben Gunnee. "There should be consistency. Even with the optimal asset allocation, the question to trustees is whether they have the time and expertise to find the right manager, then rebalance and add in new ideas in a timely manner."

Appointing a fiduciary manager means having the appropriate – and aligned – risk management from the very start of the process.

"From the planning stages, trustees take a holistic approach and delegate work as the implementation of the plan is given to experts in their field to carry out," says Scott-Douglas. "The fiduciary manager is concerned with the entire strategy. From the planning to implementation. This allows trustees to focus on the most important issues."

Crucially, however, the absolute fiduciary responsibility remains with the trustees, some of whom have so far been hesitant about handing over the keys to the car.

"We understand the initial instinct of trustees losing control," says BMO GAM head of UK fiduciary investment, David Hickey. "But the feedback has been the opposite. Trustees feel more control and they can spend their time budget on key matters."

Alignment of key measures allows better and more-efficient decision making, he says.

"Every client is different: needs, spend, convent, expertise, investment beliefs," says Hickey. "It is important when building up a proposition that there is open architecture and it is highly tailored to what they are and what they need."

Along with this additional time back in their diary to focus on what really matters, fiduciary management clients are closer than most to new ideas.

Bright ideas

"Fiduciary management gives schemes the quickest and purest access to best ideas as they go directly into a portfolio," says River & Mercantile Solutions co-head of solutions Ajeet Manjrekar.

For Manjrekar, fiduciary managers should be constantly looking for investment opportunities and to improve risk management.

"I want all our clients to be able to access our best ideas," he says. "We are agnostic whether the client is fiduciary or advisory – everyone should and does have access to these same best ideas, but fiduciary management clients have the quickest access."

While some trustees still want to pull the trigger on these new ideas themselves, a fiduciary management client's quick access is a valuable way to 'upskill' their investments, according to Scott-Douglas.

"Delegating the implementation of investment means managers can make adjustments on a day-to-day basis," she says. "The speed of implementation and adjustment is rapidly speeded up."

This approach is not just important on the asset side, but concerns liabilities too.

"There are in-built triggers that can be activated when there are material changes, internal to the company or external factors," says Scott-Douglas. "These triggers can automatically de-risk, at levels that were agreed at the outset as part of a flightpath, so a scheme does not miss an opportunity."

Stressed out?

This quick-fire approach may be useful in the coming months and years as geopolitical risks take hold of international markets.

"For our fiduciary management clients, we stress-test portfolios for unexpected outcomes," says Gunnee. "We don't position a portfolio to try and make on something, such as the Brexit vote, but we position the portfolio, so it is not negatively impacted by one outcome or another."

This is not typically something advisory clients would get from their investment consultant, nor is it likely that disparate asset managers would come together to test each of their client's overall exposure.

"The majority of advisory clients won't have had their portfolios stress-tested, nor be in a position to react quickly as markets move," says Gunnee. "After the Brexit referendum result, our clients' funding positions barely moved, whereas, according to the Pension Protection Fund's *Purple Book*, the average UK pension's funding position fell by 4 per cent."

But don't all these added extras make fiduciary management much more expensive? If it was once the case, huge new competition in the market has pulled fees down.

"Over 15 years, competition has increased," says Scott-Douglas. "Initially, large schemes were working with investment consultants to put in place complex strategies of active management, including LDI, which wasn't as streamlined as today, and the fiduciary management fee was like ad valorem to what they were already doing."

New entrants to the market have driven fees down – both the underlying costs of the investment management and the fiduciary management bill itself.

"Fees are coming down across the industry and the Competition and Markets Authority's requirement for firms to go to tender will increase that further," says Manjrekar. However, he warns that there is still a variety of fees, that only regulation will change.

"Transparency is key," he says. "Trustees need to see the scale of fees and a breakdown of what is being paid."

This transparency is also important to show trustees just what they are getting for their money, according to Hickey.

Getting what you pay for

"If you take on a fiduciary manager, you are not paying them by the hour. It's a different approach," he says. "It is more aligned as you are all working towards the same outcome: improved funding levels. It's logically better for the scheme."

If switching from simple advisory using all passive funds, fees can go up, but for Scott-Douglas, there is good reason. "It's really a different service you're paying for," she says. "It's not comparing like with like. Taking on the oversight is a whole new approach."

For Gunnee, trustees need to think about what they are prepared to pay to get where they want to be more quickly – and the extra services it will entail to do it.

"The only similarities to the advisory model are the advice given and the quarterly meetings/reporting," he says. "The rest – the portfolio adjustments, the automatic de-risking, the dynamic tilts, the cashflow modelling, the operational elements – that's all additional services that come with fiduciary management."

Could fiduciary management, on balance, therefore, end up cheaper?

"Even when it is more expensive, it is by a matter of basis points and what you're paying for is the outcome," says Gunnee. "You might be paying 10bps but getting 20bps of return and getting to full-funding more quickly. The results show it does outperform advisory, but trustees need to see a track record in a transparent way."

Written by Elizabeth Pfeuti, a freelance journalist