The fiduciary management reckoning

Louise Farrand considers the continual impact from the 2022 gilt crisis and the fiduciary management reviews it has generated

Summary
- Fiduciary management is entering a new phase, prompted by several seismic events: The gilts crisis in autumn 2022 and the Competition and Markets (CMA) review of the market.
- More broadly, the market is evolving and maturing, as new players enter the market and consolidation happens.
- Many DB schemes are going through strategy reviews to learn lessons from the gilts crisis. What should they consider – and what other trends are defining fiduciary management?

The repercussions of the gilts crisis of autumn 2022 are still reverberating for many DB pension schemes. Trustee boards were already concerned that they were not responding quickly enough to fast-changing markets; the financial crisis of 2008 demonstrated that investing in a straightforward mix of equities and bonds would not deliver their funding objectives.

Few pension schemes were able to move quickly enough to take advantage of opportunities in the aftermath. "Post 2008, and going into 2009, trustees were slow to move into what turned into a 15-year bull market," observes TPT head of investment, Peter Smith.

The introduction of in-house chief investment officers and fiduciary management gathered pace in the UK after the events of 2008. But despite all the lessons learned, DB schemes were unprepared for a seismic event like the gilts crisis of autumn 2022.

Nobody expected it. The gilts crisis categorically debunked the myth that equities and bonds are uncorrelated and raised questions about DB pension schemes' widespread use of liability-driven investment (LDI) strategies.

Despite their post-2008 move towards delegated governance and the implementation of swifter decision-making, many DB schemes – and their fiduciary managers – were not immune to the volatility. As XPS Group head of fiduciary management oversight, André Kerr, recalls: "There were some fiduciary managers that had an absolute disaster during the gilts crisis."

TPT commercial director, Nicholas Clapp, adds: "The gilts crisis threw everyone into a spin. I thought that six months later there would be a collective review of where people were, because the fiduciary management governance structure did not hold up well in the gilts crisis. I anticipated that would result in new appointments and reviews. However, the pace has been slower than anticipated, and we are only getting to that now."

The reason for the delay is the abrupt improvement in DB schemes' funding levels, adds Smith. "There has been a whole heap of work to be done from an investment perspective. DB schemes have had to get on top of that first. They are in an entirely different place, so what does their end goal now look like? Only after that has been established can schemes start think about what vehicles will take them to that destination."

Governance reset

The majority of DB schemes which use fiduciary management are going through a strategic review at present, reports Isio partner and head of fiduciary management oversight, Paula Champion. Trustee boards are resetting their objectives and thinking about different governance options, she says. In particular: "They are thinking about whether they get help and guidance and assistance with assessing their fiduciary manager and making sure they are doing a good job," she reports.

Fiduciary managers are also learning lessons from what happened during the eventful autumn of 2022 – particularly in terms of managing their exposure to illiquid assets. Champion explains: "Off the back of the gilts crisis, trustees were much more conscious of having enough cash collateral for their LDI portfolios and making sure those were managed effectively. There is a need and a want for trustees to have more liquid portfolios and to monitor the liquidity of their portfolios over time.

"This means two things for fiduciary managers. One, they want to make sure they have got differentiating assets that are illiquid – so alternative illiquids. And two, they are ensuring they have their reporting and communication aligned to what trustees want – so, evolving their reporting for fiduciary clients to give them greater visibility and shed light on the liquidity of the portfolio."

Under pressure

Before the gilts crisis, fiduciary managers were growing fast. "Gilt yields were falling, so even if they did nothing they were growing. I think most fiduciary managers expected that trend to continue," recalls Kerr, adding: "When things started to turn it became a very different situation: cost pressures, gilt yields going in the opposite direction, fees going down because of new entrants to the marketplace. It was not the easiest of marketplaces for fiduciary managers to operate in and it put a lot of pressure on them as businesses."

Champion agrees, adding: "We have seen fees ticking up. One in three fiduciary managers have increased their fees over the past year or two. So, while there was an increased saving on the back of the CMA review, I think some of that has been whittled away by inflation and the pressure on fiduciary managers."

The CMA review has had other positive effects on the market, Champion qualifies. "When the review happened, we were in a position where a lot of schemes had to take their fiduciary managers out to a competitive tender. I think that helped fiduciary managers to sharpen their pencils, not just in terms of fees, but also in terms of servicing, trying to very succinctly communicate their USPs as well. It helped to put a little bit of space between the different types of fiduciary manager and their areas of expertise. In that way, it made the market clearer and more transparent."

Kerr is still unconvinced that the market is transparent, particularly when it comes to comparing performance. He argues: "Fiduciary managers have a massive asymmetry of information, and I would argue that most trustees aren't able to make a judgement call on whether they are doing a good job or not."

He suggests trustees should be unafraid to challenge their fiduciary manager and have a strong framework in place: "Don't just accept that what they say is correct. The difficulty is, a lot of people don't feel they are able to challenge properly; they don't like asking questions that make them look difficult or feel stupid. Generally, if you have a question that you want to ask, ask it! Other people will probably not know the answer as well. Don't be afraid to channel your inner five-year-old and keep asking: 'Why?'"

What's next for the fiduciary management industry?

Larger mandates are becoming more common, reports Clapp. "Fiduciary management has worked its way through the sizes over the years – slowly going up through the sizes, starting with smaller schemes."

Now, very large schemes are thinking about it, Clapp says, explaining: "In the big picture of things, UK DB schemes are small asset owners. It's not about UK rankings – it's the context of who are the global asset owners that are able to negotiate strong contracts with different fund managers to the benefit of their clients."

With many boasting much improved funding levels, DB schemes are also reviewing what their end games now look like. Champion says: "All these discussions are very active. In terms of the proportion of schemes that have come to a conclusion on that, we are less sure at the moment … fiduciary managers are very cognisant of the fact that they need to address that with trustees and talk about it."

Another growing trend is a reshaping of the fiduciary management market, with new entrants to the market – such as TPT Investment Management – and consolidation of fiduciary managers, says Zedra client director, Daniel Walsh. "Mercer are acquiring Cardano, and there's a sense that this may not be the end of consolidation."

Trustees should be unafraid to ask hard questions, says Walsh. "If you've appointed a manager because you believe in their philosophy and their approach, if they're then acquired or acquire another firm, what does it mean? Ask what's happening and what it means for the proposition going forward."

Fiduciary managers are confident about the future. "We anticipate there is significant growth still to happen – both in terms of schemes embracing it and schemes switching over for a different approach," says Clapp. "We also think there will be more options in terms of endgame solutions but also in terms of operating models available to pension schemes in the fiduciary management world."

Written by Louise Farrand, a freelance journalist

In association with tpt Retirement Solutions