



Latest trends in Fiduciary Management

2022 Isio UK Survey

isio.



Fiduciary
Management
Survey 2022

Snapshot of the fiduciary management market 2022

Growth, market uncertainty, and increasing Trustee regulations



For the first time since pre-2008, we have seen Assets Under Management (“AUM”) in the Fiduciary Management (“FM”) market fall despite an increase in the number of fiduciary mandates. Market conditions have clearly tested fiduciary manager portfolios and risk controls, highlighting the importance of independent oversight of fiduciary mandates. This comes at a time when ESG regulations for pension schemes are increasing, and the competitive landscape for fiduciary managers changing. The trend of larger schemes appointing an Outsourced Chief Investment Officer (“OCIO”) continued and we have seen consolidation of FM providers - will these trends continue?

In July 2021, it seemed the industry might see some respite as pressures from the June 2021 Competition and Markets Authority (“CMA”) Order deadline eased and investment markets showed a sustained period of recovery from the Covid-19 pandemic. However, in early 2022, concerns in investment markets shifted towards inflationary pressures and the prospect of rising interest rates, with further headwinds coming from the war in Ukraine. Against this challenging macroeconomic backdrop, investment markets have experienced declines across asset classes globally and a sharp rise in real and nominal gilt yields, which have only become exacerbated in the months following 30 June 2022.

Key messages

Market Update

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Overall growth in the FM space was positive and has increased since our last survey. Despite this, the growth rate is not yet back to pre-2020 levels leading us to question: has growth peaked? Over the year we have also seen a decrease in AUM, which is the first fall we have seen in overall asset values since pre-2008.

Environmental, Social and Governance factors

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The industry continued to adjust to new regulations, particularly in relation to Environmental, Social and Governance (“ESG”) factors, with large schemes paving the way on Task Force on Climate-Related Financial Disclosures (“TCFD”) requirements. These new regulations, alongside other factors such as the increasing importance of setting Long-Term Objectives, have contributed to greater governance burden for schemes of all sizes. We suspect this could be driving more schemes towards FM, particularly smaller schemes.

Alternatives favoured over equity

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Asset allocation is evolving. Over the past three years we have asked fiduciary managers how they would invest assets of a scheme with the £500m of assets targeting a return of Gilts + 2% per annum, and the average portfolio looks different from three years ago. Notably we have seen a move away from equities towards credit and LDI. We expect to see further change after 30 June 2022 given the recent volatility in gilt markets.

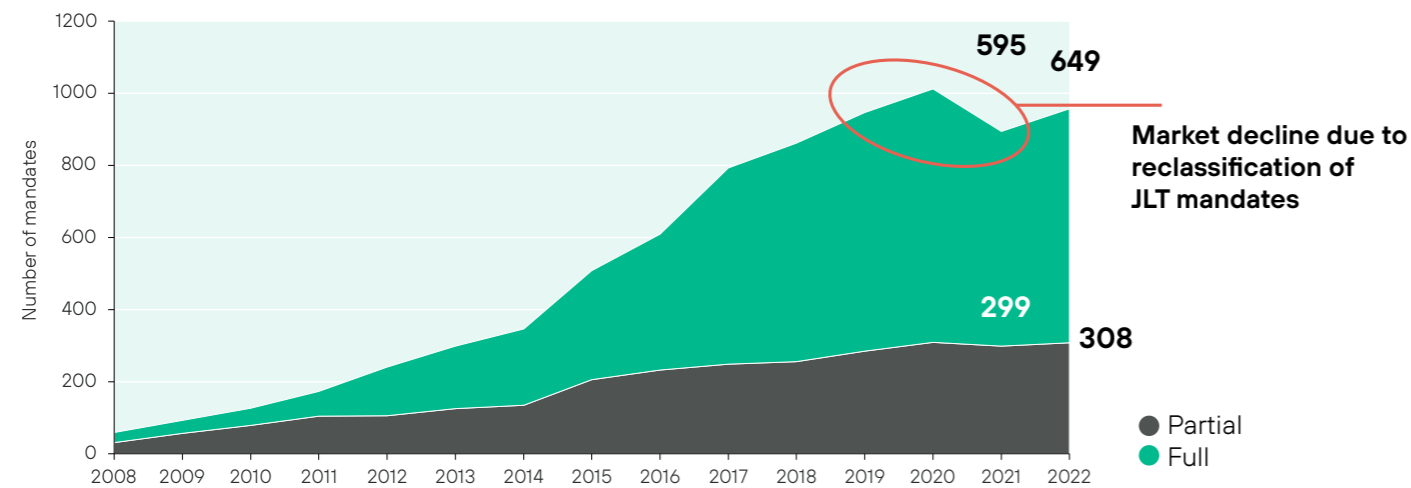
Market Update

Growth continues, although still not back at pre-2020 levels

A year after the CMA June 2021 deadline¹, the industry seems to be settled back to more normal levels of selection activity and the rate of growth in the number of mandates increased over the year. This higher growth rate may reflect a back-log of schemes that deferred implementing mandates over 2021. Even so, the rate of growth of 7% remains below pre-2020 levels of growth. It will be interesting to see if slower growth becomes a more permanent feature in the industry.

Growth increased over the year but remains at lower levels. Has growth peaked?

Growth in the Number of Mandates



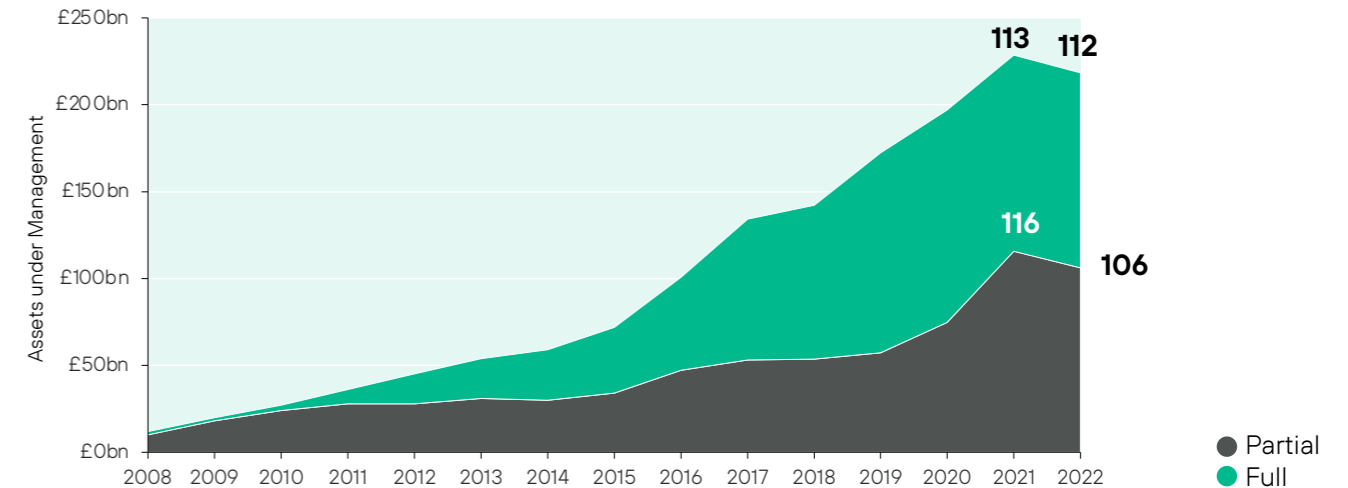
¹ Schemes were required to retender their fiduciary manager by 10 June 2021 if they had not originally been appointed by competitive tender.

The AUM has decreased by c.5% over the last year. This is the first year we have seen a decrease in AUM in the FM market since pre-2008. We believe this is mostly due to the impact of rising gilt yields, leading to significant declines in the value of gilts and Liability Driven Investment ('LDI') assets for many pension schemes. Growth assets also experienced challenging conditions in the first half of 2022, further contributing to the fall in overall assets this year. These market conditions outweighed the rise in assets from pension schemes that were new to fiduciary management over the year.

This decline in AUM over the year was particularly driven by partial fiduciary assets which fell by around 8%.

Over the year we have seen a few large schemes enter the market through OCIO solutions with fiduciary providers. While these mandates have been included in the AUM totals for this year, due to their large size, without these the fall in AUM seen would have been greater.

Growth in Assets under Management



Over the year we have seen a change in the composition of the market when comparing FMs across consultancies, investment managers and FM specialists. Investment managers have seen the greatest increase in the number of full FM mandates (85% increase from 2021) relative to specialists (9% increase from 2021) and consultants (14% decrease from 2021). This change in numbers between investment managers and consultants can be explained to some extent by consolidation of fiduciary providers within the market.

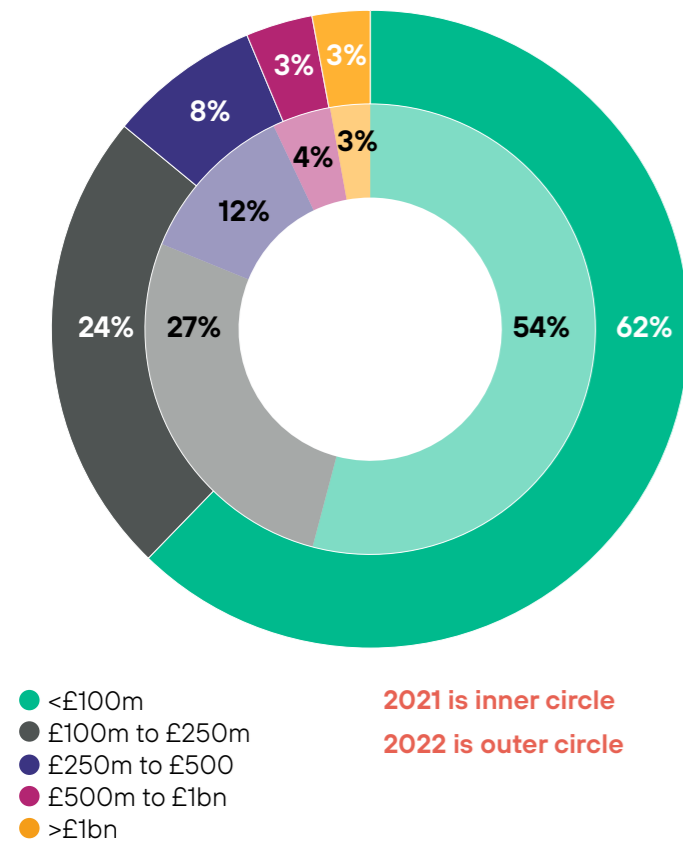
We look forward to seeing how this changes the competitive landscape and if it encourages further consolidation in the future.

Continuation of growth and future of FM

Market composition continues to evolve, with an increase in the number of mandates <£100m in assets

Large clients dominate the market by AUM and smaller clients dominate the market by number of mandates.

Proportion of Mandates by Size

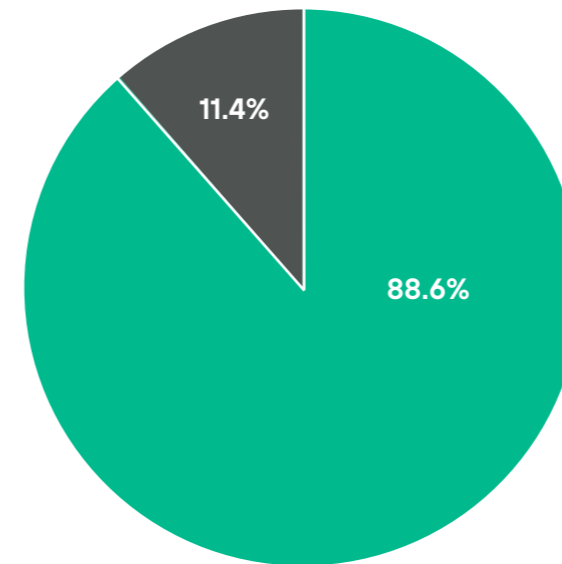


Schemes of a range of sizes use fiduciary management. 18%¹ of the UK Defined Benefit (“DB”) schemes use some form of fiduciary management, and over the last year the distribution of full FM clients has changed over the year. In particular, we have seen an increase in the number of smaller clients (below £100m AUM) relative to larger schemes of over £100m AUM. While the number of clients with assets over £1bn has increased, the percentage of the market that this represents remains broadly similar.

This could be explained by the fall in AUM seen over the year, meaning that more clients within the market now fall into the below £100m bucket. It is also possible that increased governance burden of regulations and reporting, for example in relation to ESG and setting Long-Term Objectives, has highlighted the merits of moving to FM and encouraged smaller schemes to enter the market. We have also seen an expansion in small scheme options being offered by fiduciary managers which will have made the move more achievable for these schemes.

¹ This is based on our findings for the total number of UK DB schemes using full and partial fiduciary management as at 30 June 2022 compared to the number of schemes in the PPF Purple Book 2021, which is listed as 5,220 eligible UK DB schemes.

Number of mandates (Full & Partial) - DB vs DC



● DB Pension Schemes
● DC Pension Schemes

As more and more defined benefit (“DB”) pension schemes mature and reach buy-out, there could be significant implications for the future of the FM market. Currently DB schemes make up the majority of the market by number of mandates (89%). However, as fiduciary managers have diversified their offering in recent years to include defined contribution (“DC”) schemes, we have seen an increase in their presence in this market.

This chart to the side is based on fiduciary managers’ definition of FM for DC schemes, we have not provided a definition.



Environmental, Social and Governance factors

Fiduciary Managers are supporting the increase in ESG regulation

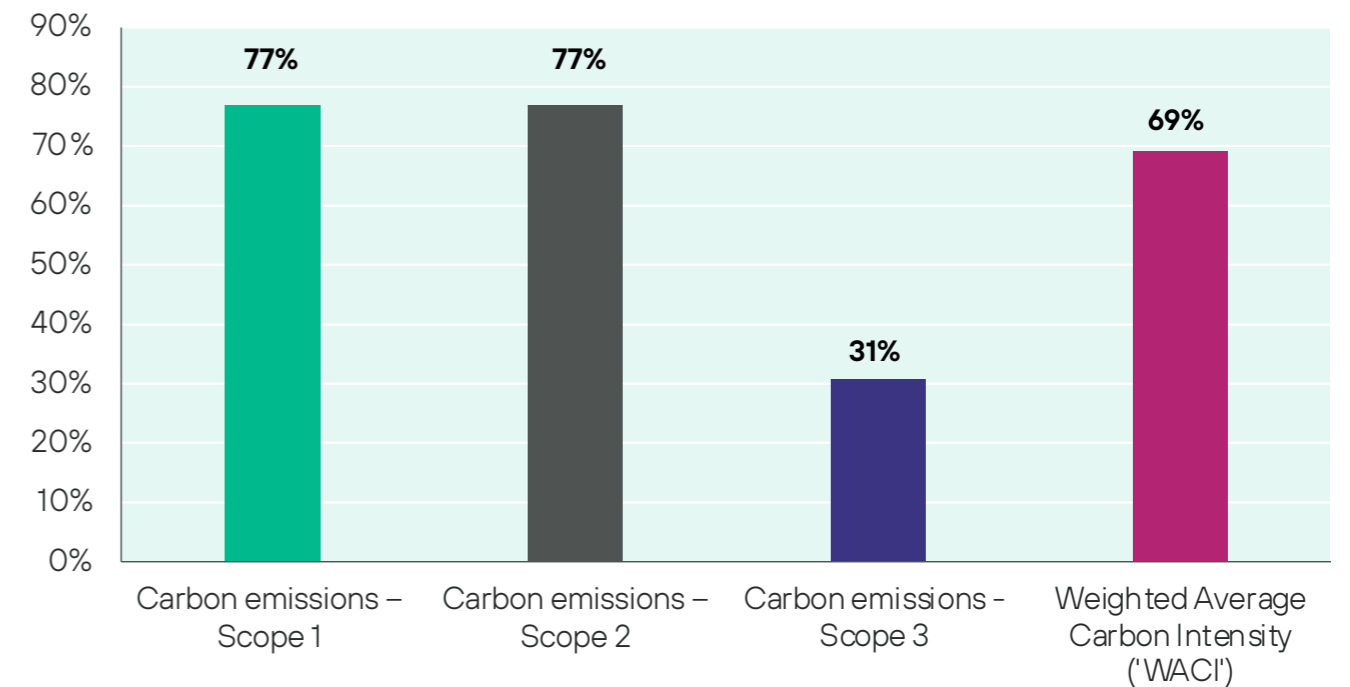
- ESG continues to be an increasing area for regulatory change. Whilst the Task Force for Climate-Related Financial Disclosures (TCFD) reporting requirements are currently only in force for schemes with assets exceeding £1bn, we expect this to be extended out to all schemes in the foreseeable future. This has proved governance heavy for the larger schemes so it is hoped that, via the FM model, some streamlining of data collection will make this less of a burden for smaller schemes.
- As these regulations have only been rolled out for larger schemes so far (representing 3% of full mandates and 8% of partial) there is varied experience across the fiduciary managers. Those with clients of this size will already have the infrastructure set up to deal with these requirements and will have learnt from their experiences so far. Whereas some fiduciary managers may still be building their processes.

Fiduciary managers are moving in the right direction but there is still work to do.

c.70% of fiduciary managers can provide key TCFD metrics for all fully delegated schemes.

Average data coverage of c.50% of model portfolios for Scopes 1 & 2 and WACI (c.10% for Scope 3).

FMs that provide TCFD Metrics for Full FM Clients



The chart shows the percentage of fiduciary managers that can provide carbon emissions data and Weighted Average Carbon Intensity (WACI), carbon emissions data weighted by company sales. We believe all managers should be able to provide Scopes 1 and 2 carbon emissions (using the standard industry definitions) and WACI currently and they should all be working to provide Scope 3 at acceptable coverage levels by the end of 2023.

Here we have focused on carbon-based metrics while in practice managers must also provide additional metrics.

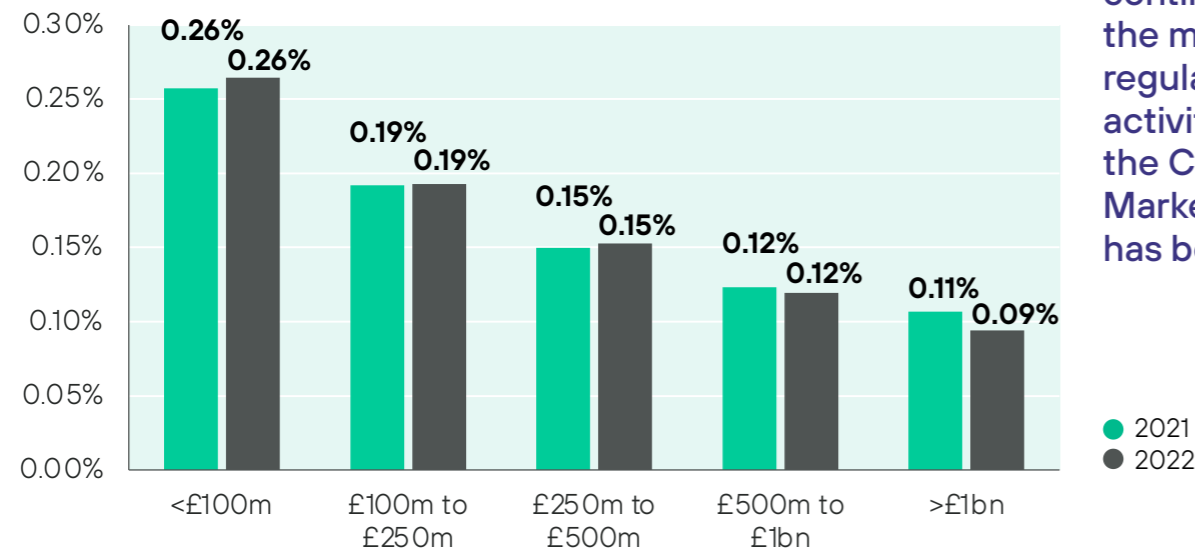
Definitions of Scopes 1, 2 and 3 can be found using the link: [Metrics and Targets - TCFD Knowledge Hub \(tcfddatabase.org\)](https://www.tcfddatabase.org/TCFD-Knowledge-Hub/Metrics-and-Targets)

% of FMs that could provide a response - 13 FMs

Fees

Still seeing positive effects of the CMA review

Average FM Fee by AUM (%)



Will this trend continue now that the majority of regulatory retender activity required by the Competition and Markets Authority has been completed?

Each year we ask fiduciary managers what their FM fee would be for a scheme targeting a return of Gilts + 2% per annum in five different asset size buckets. The data shows little movement in fees over the year with the exception of schemes of £1bn+ in size. In the previous year we saw an increase in fees for schemes of £1bn+ (from 0.10% to 0.11%), it now appears the fee pressures realised for other scheme sizes over the past 2 years are now being seen for these larger schemes. We see 3 key drivers for this:

1. Continued retender activity prompted by the CMA review
2. Competitive pressures in the market between fiduciary managers
3. Operational costs decreasing e.g. technology improvements and economies of scale

Across the market fees are priced on assets under management ("AUM") – what happens in the current environment of falling AUM – in theory costs for schemes will decrease, will this cause fiduciary managers to reassess their pricing models?



Long Term Objectives

Clients are further along their journey's

Clients are moving rapidly along their journeys towards buy-out and self-sufficiency. This has only been amplified by market conditions over the past few years as strong performance of growth assets in the post March 2020 environment has combined with a recent decrease in buy-out liabilities as yields have risen. As expected, because of this we are seeing higher liability hedging targets across all fiduciary managers up to June 2022.

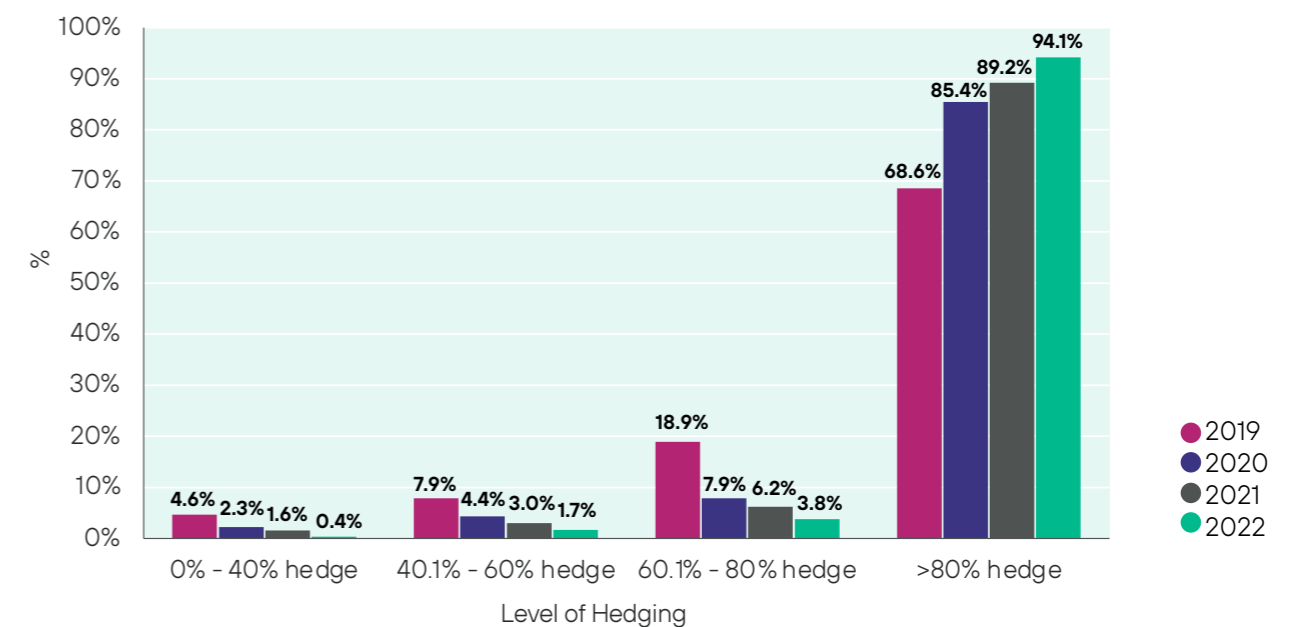
This has also led to return targets decreasing, but what does this mean for the future of FM? As growth becomes less of a key objective how will fiduciary managers adapt? Our research has shown that the majority of fiduciary managers already either provide insurance services in-house or have partnerships with insurance providers.

A Department of Work and Pensions funding and investment regulations consultation is taking place towards the end of 2022, which might result in end game planning and long-term objectives becoming more prominent.

Hedging levels increased further - will this trend continue?



Average percentage of FM clients at each liability hedging level



Return Targets



Alternatives favoured over equity

Schemes moving away from more "traditional" growth assets

We asked fiduciary managers to tell us how they would invest the assets of a £500m scheme and targeting a return of Gilts + 2% per annum. The charts on this page are based on the average response.

Over the past 3 years we have seen a significant change in the average strategic asset allocation. In particular, we have seen a diversification away from reliance on equities to drive return. A result of this is an increase in the average allocation to credit as managers have found attractive new investments in this area. This diversification will have been beneficial to schemes during the volatility of equity markets over the year.

Despite the change in return drivers over the years it is important to note that the target return has remained constant. Fiduciary managers have worked to decrease risk in 2 main ways:

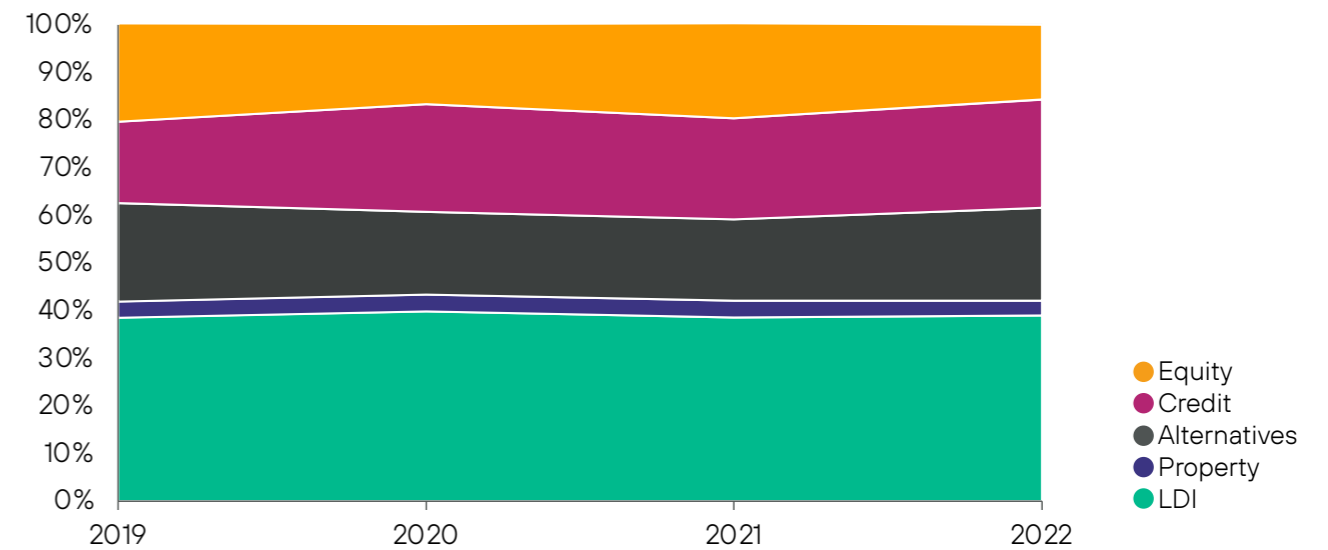
1. Increasing the role of LDI within portfolios
2. Diversifying away from equities

As well as these high-level strategic changes, within each asset class there have been changes based on perceived opportunities and movement towards more ESG focussed funds.

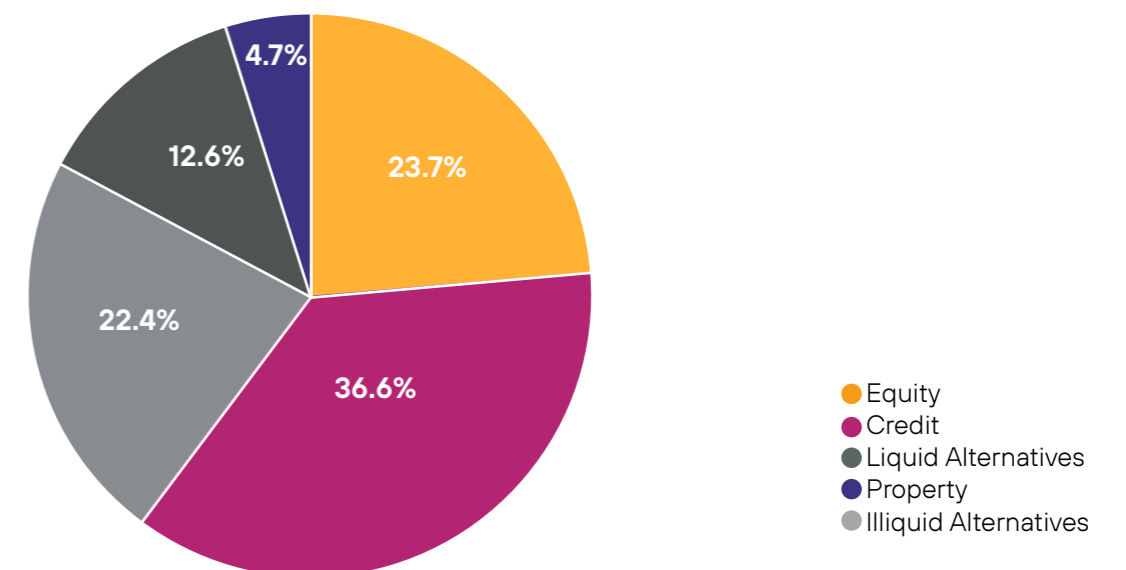
At the time of writing we were in a rising gilt yield environment and this is likely to impact fiduciary manager's strategic asset allocation to LDI. We view there are three levers they have at their discretion: decreasing hedging levels, a higher allocation to LDI (given new required leverage levels) and decreasing the return target.

Within the equity allocation there has been a focus on incorporating ESG tilts.

Asset allocation changes over the last 3 years



2022 best ideas growth portfolio



Isio and Fiduciary Management advice



Fiduciary management expertise

We provide ongoing independent fiduciary oversight to clients ranging from less than £20 million in size to over £4 billion.



Investment advisory expertise

Our traditional investment advisory practice advises the trustees and corporates of UK DB pension schemes and others, with assets under advice of over £120 billion.



Wider pensions resources

We can bring you experts in trustee board governance, insurance and risk transfer solutions, Defined Benefit and Defined Contribution services, or any other areas required in advising on how best to meet your scheme objectives.

What can we do for you?

Governance review

Ongoing monitoring and oversight

Onboarding and document review

Provider selection and retenders

Provider review

Ad hoc fund review and selection



Who took part in our survey?

The survey results presented are based on the responses received from the following fiduciary managers operating in the UK Defined Benefit pensions market with data as at 30 June 2022.

We thank each provider for their input in this exercise. We have relied on the information provided to us by the fiduciary managers as being correct.

- Aon
- BlackRock
- Cambridge Associates
- Cardano
- Charles Stanley Asset Management
- Columbia Threadneedle
- Goldman Sachs Asset Management
- Kempen
- Legal & General
- Mercer
- Russell Investments
- Schroders
- SEI
- State Street Global Advisors
- WTW

Definitions used in this survey

Full delegation

The fiduciary manager provides the full delegated service and is engaged under a formal agreement to manage 100% of scheme assets. Service provision will typically include all, or most of: journey plan design, strategic and tactical asset allocation, growth and matching portfolio structuring, setting a target liability hedge ratio, investment manager selection, implementation and administration. The mandate objective is typically to meet a funding level/liability target within a prescribed timeframe. It must be a complete service with no additional investment advice required from a third party.

Partial delegation

Trustees delegate only a subset of investment management to the provider. It may be that only a portion of the scheme assets are delegated to the fiduciary manager or only certain responsibilities. For example: growth portfolio management, tactical asset allocation or manager selection. Mandates where the liability hedging target is not set by the fiduciary manager are defined as partial delegation. The partial delegation assets under management reflect only the assets delegated. In order to qualify as partial FM the service must be a subset of an alternative full FM service provided by the same firm.

Environmental, Social and Governance ('ESG'):

Environmental, Social and Governance ('ESG') is investing with an awareness of the wider risks associated with the impact of their investments on society as a whole.

ESG can be defined within the headings:

- Environmental: How an investee company performs as a steward of the natural environment.
- Social: How a company manages relationships with its employees, suppliers, customers and the communities in which it operates.
- Governance: Looking at a company's leadership, executive pay, internal controls, external audits and shareholder rights.

Engagement is defined as the inclusion of an ESG item on a trustee or investment committee agenda which you have discussed in the year to 30 June 2022.

The purchase of annuities for some, or all, members in the name of the scheme. The annuities are held by the scheme as an asset.

The purchase of immediate annuities for pensioners and deferred annuities for non-pensioners, in the names of the members of the scheme.

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