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Latest Trends in Fiduciary Management

2024 Isio UK Survey

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fm. Fiduciary Management Survey 2024

Snapshot of the Fiduciary Management ("FM") Market for 2024

UK FM market growth remains muted amid an uncertain economic environment

Welcome to Isio's 15th annual Fiduciary Management Survey. This year we observe big changes in the fiduciary landscape. Investment markets have stabilised somewhat since 2022's "gilts crisis". However the shake up in markets, and how fiduciary managers have responded to this, has seen new trends emerge.

Whilst many Defined Benefit pension schemes still require growth to help them achieve their objectives, other schemes are close to being fully de-risked. Following the "gilts crisis", there has also been much greater emphasis on the risk management capabilities of fiduciary managers. Insurance and run-on have become increasingly popular endgame objectives for schemes using fiduciary management. These diverging needs are creating new demands of fiduciary managers, both in their service capabilities and their investment ideas.

We found that our clients increasingly value our input on the optimal investment governance model for their schemes. It is apparent to us that trustees, company sponsors, and pensions advisers are placing more focus than ever on how investment goals are achieved. Governance reviews across the industry continue to debate how the fiduciary management model can be better aligned to each scheme's individual circumstances. This points to an evolution in how fiduciary managers fit into the puzzle, both now and in future.

As new managers enter the market and further consolidation occurs, we think this evolution brings with it both possibilities and pitfalls for schemes using fiduciary management.

Key messages

Slow growth in the number of fully delegated mandates - driven by schemes exiting the market via an insurance transaction balanced with those seeking to reduce their governance burden.

Assets under management increased, supported by positive performance of assets - and due to a small number of very large schemes moving to fiduciary management.

Average funding level of schemes using fiduciary management is higher than ever before - more schemes are targeting insurance as their end-game objective.

An increase to the illiquid allocations in target portfolios – suggesting liquidity concerns have stabilised.

Continued improvements in ESG reporting by FMs – two thirds of fully delegated fiduciary mandates now have a net zero carbon emissions target in place.

Over a third of fully delegated mandates also use some form of independent oversight – marking the highest level since our survey began.

Click on each icon to read more

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FM Market Update

Slower mandate growth over 2024

Despite expectations that the number of fiduciary management mandates in the UK DB pensions market would increase, market growth has been broadly flat over the last 12 months.

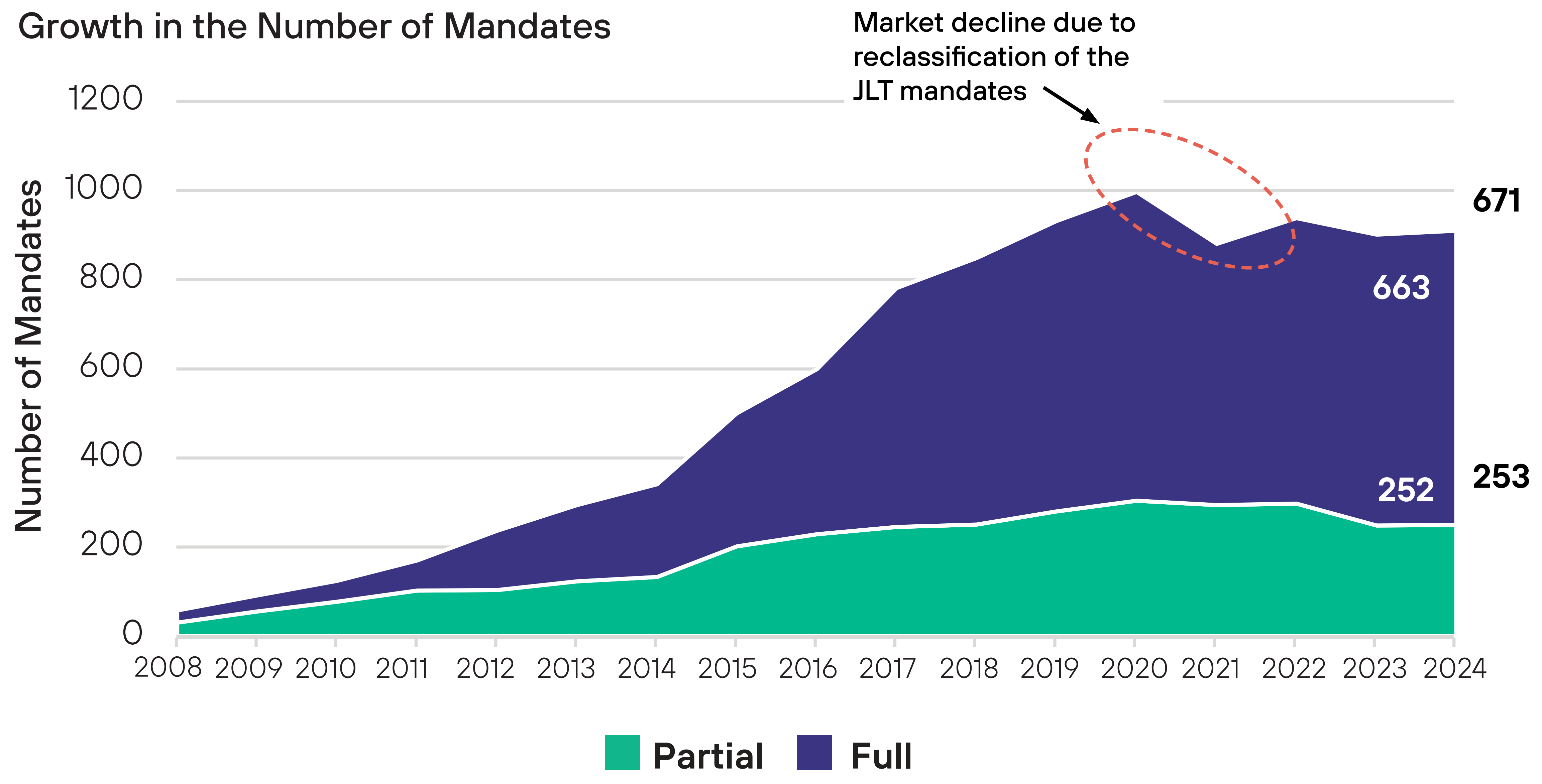
Fiduciary market growth was around 1%[1] over the year to 30 June 2024, with partial mandates increasing by 0.4%[1], and 1.2%[1] for full fiduciary mandates.

Significantly more schemes have a better funding position and are managing a lower-risk investment strategy than 5 years ago. Many trustees do not feel that their schemes require complicated investment strategies when they are targeting lower returns. With many providers adopting complex strategies, we believe this is a key reason behind slower growth this year.

Following the gilts crisis in 2022, we had expected more trustees to consider fiduciary management to help solve governance challenges. Although these factors have influenced growth, this has been outweighed by more schemes exiting fiduciary management this year.

Interestingly, out of all mandates reported by fiduciary managers as "lost", 64% were due to schemes completing insurance transactions. We expect to see more schemes leave fiduciary management in the medium term due to the improved strength of funding positions. We do, however, question whether this trend could slow or even reverse as more schemes opt to run-on over the longer term.

18%[2] of schemes in the UK DB pension scheme market use either full or partial fiduciary management.



[1]Number of mandates have been restated for 2023 assuming a consistent fiduciary manager pool for 2023 and 2024, as two managers (Columbia Threadneedle and Cambridge Associates) have not participated in the data response for 2024 due to exiting the FM market. One manager (Brightwell) has been added to the data response for 2024, we have restated 2023 to account for this. [2] % of total schemes in the UK defined benefit pension market using data as at 31 March 2023 due to availability of information (5,063). Sourced from The Purple Book 2023, Pension Protection Fund.

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FM Market Update

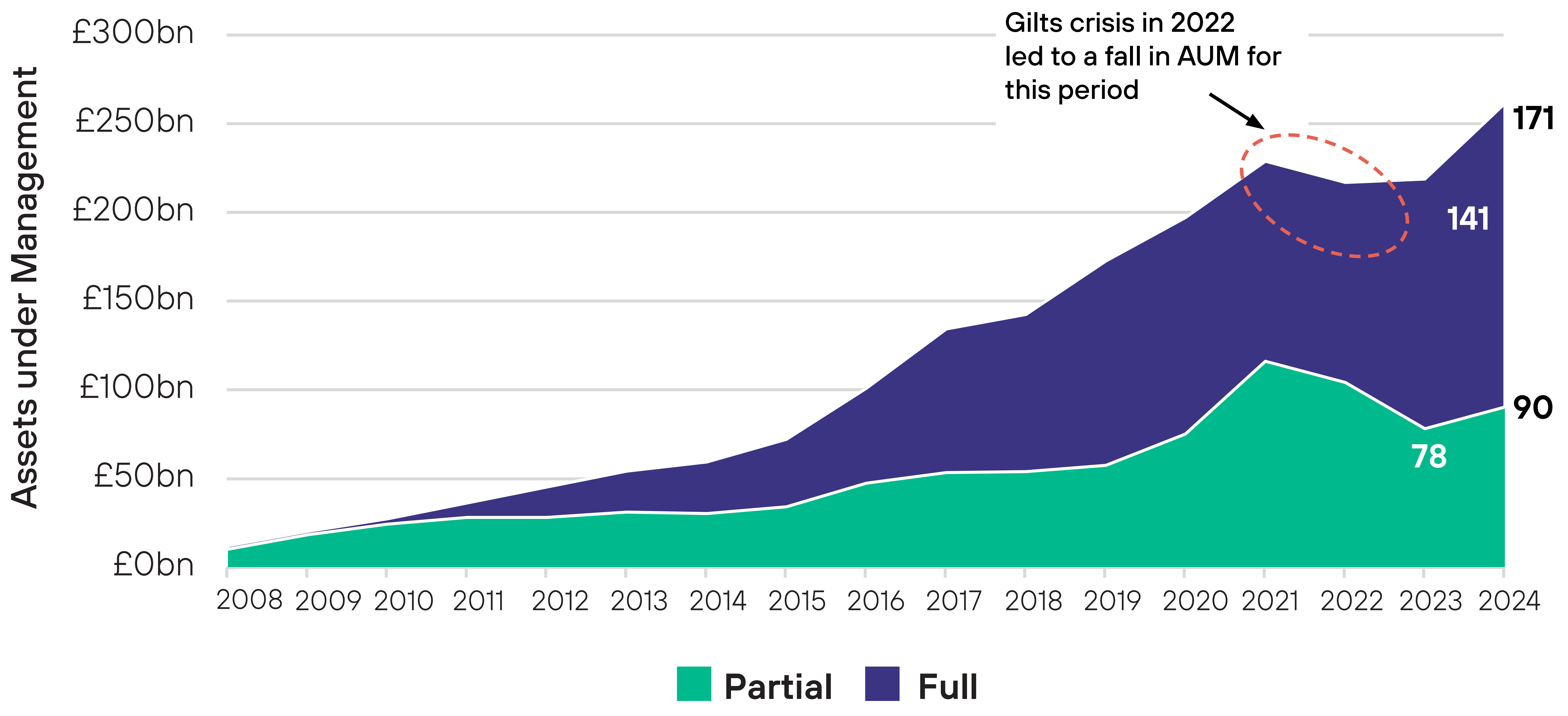
Assets under management ("AUM") continues to grow

In contrast to more subdued mandate growth, we have seen a marked increase in overall AUM within the FM market - growing by around 20%[1]. AUM for full fiduciary mandates has risen by 22% and by 16% for partial fiduciary mandates.

This may not be surprising given the continued trend of multi-billion pound Outsourced Chief Investment Officer ("OCIO") mandates entering the fiduciary market this year. Under this model, trustees often appoint a fiduciary manager to support with the implementation of their scheme's investment strategy, whilst maintaining a separate, third-party investment advisor.

We also observed strong asset performance over the 12 months to 30 June 2024, with equity markets reaching all-time highs and tightening credit spreads over this period. Over the 12 months to 30 June 2024, the FTSE World Index (GBP Hedged) increase by 21.9% and Global High Yield Credit (GBP Hedged) increased by 11.3%. We expect most schemes will have seen their growth asset values increase as a result of favourable market conditions.

Growth in Assets under Management



[1]Assets under management have been restated for 2023 assuming a consistent fiduciary manager pool for 2023 and 2024, as two managers (Columbia Threadneedle and Cambridge Associates) have not participated in the data response for 2024 due to exiting the FM market. One manager (Brightwell) has been added to the data response for 2024, we have restated 2023 to account for this.

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Composition of the FM Market

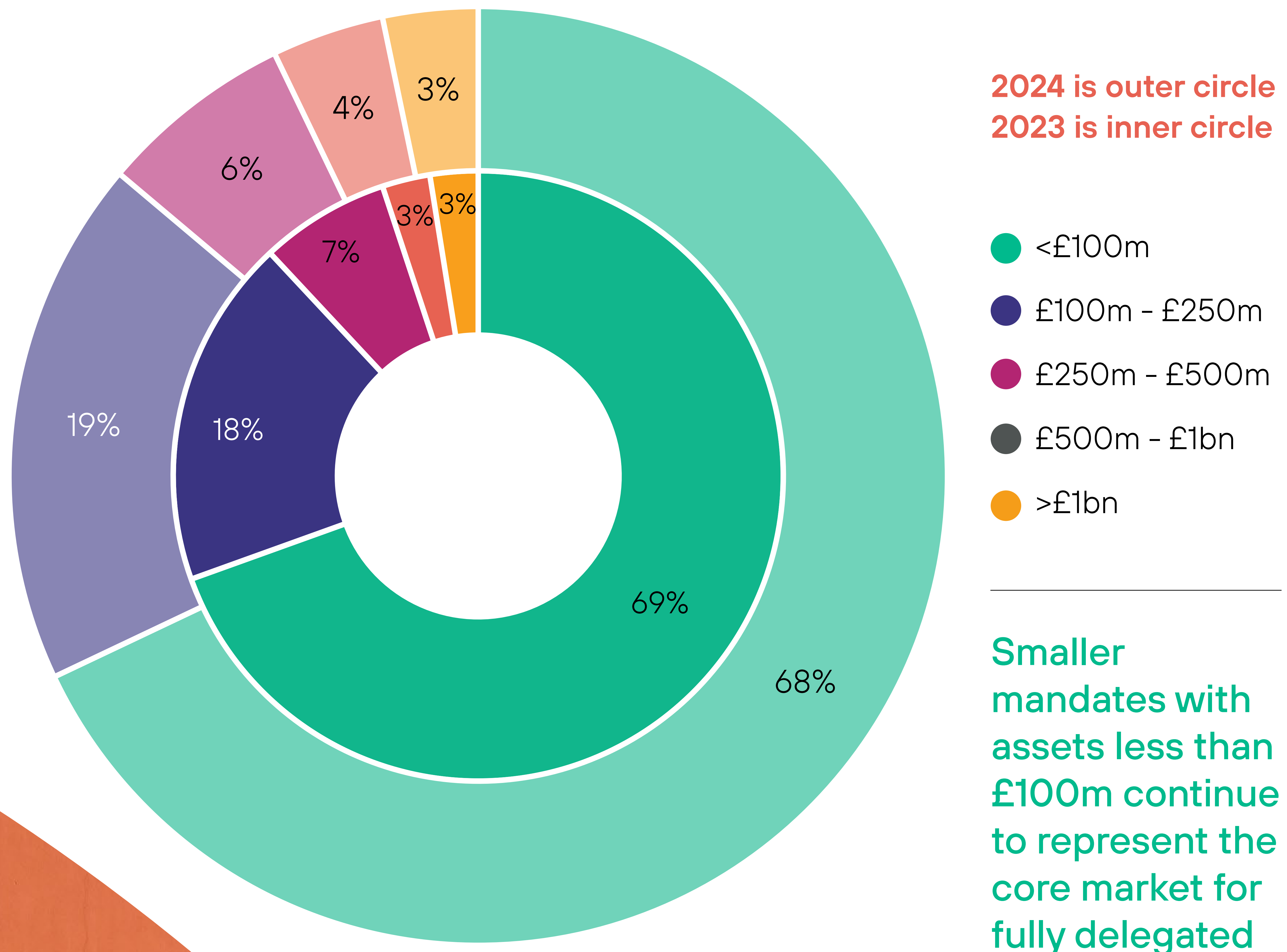
Smaller schemes still form the majority of mandates

We have not observed material changes in the makeup of the fiduciary market over the year.

Smaller mandates with assets less than £100m continue to represent the core market for fully delegated fiduciary management.

In contrast, schemes greater than £1bn in size make up 61% of the market in terms of AUM.

Proportion of Fully Delegated Mandates by Size



Smaller mandates with assets less than £100m continue to represent the core market for fully delegated fiduciary management.

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Composition of the FM Market

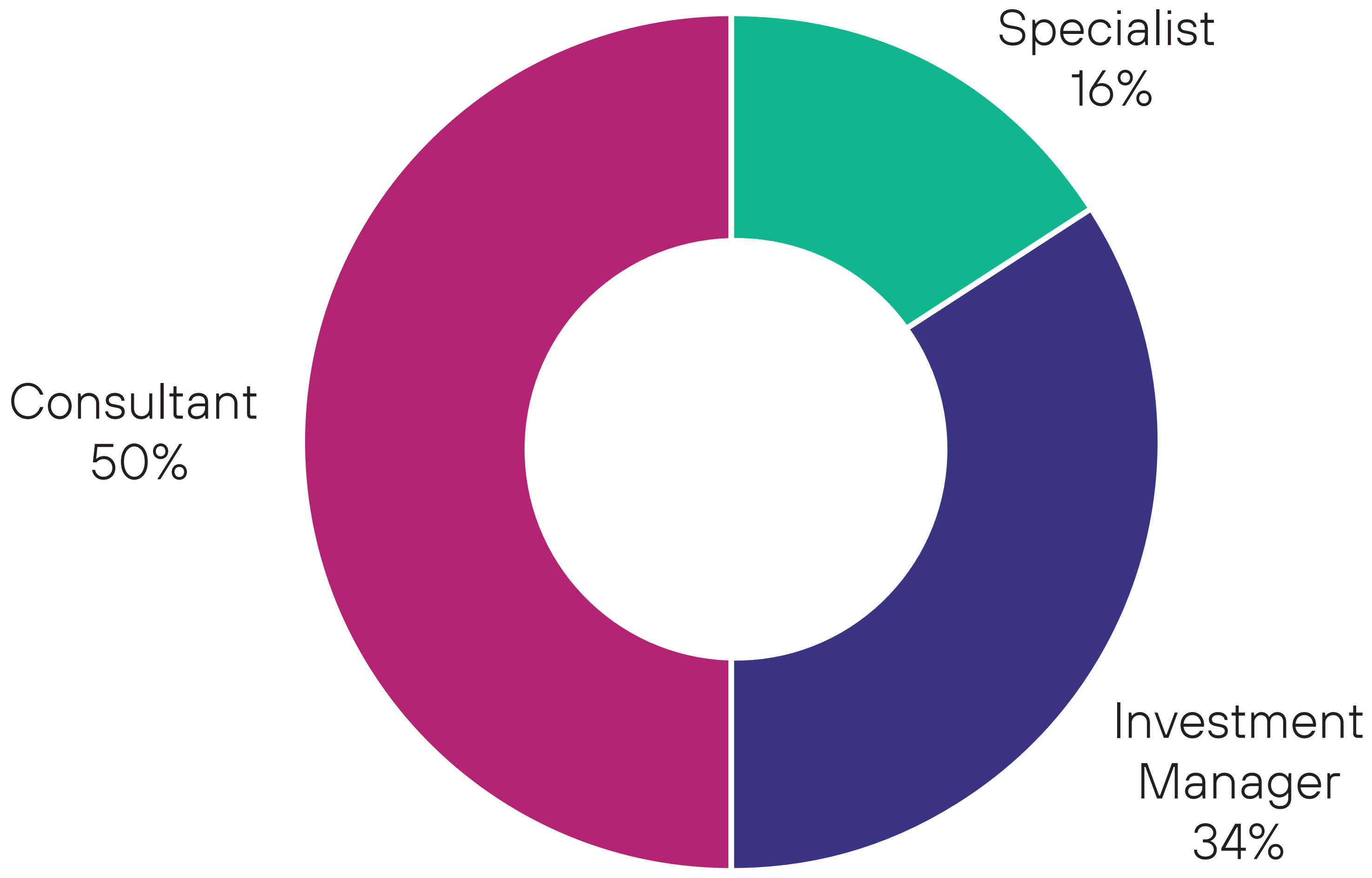
Consultants hold the most FM mandates, yet investment managers hold the most FM assets

When looking at the fiduciary market composition by provider type, FMs with consultancy heritages make up 50% of the market in terms of mandate numbers. By contrast, investment managers have the largest market share of fiduciary assets under management.

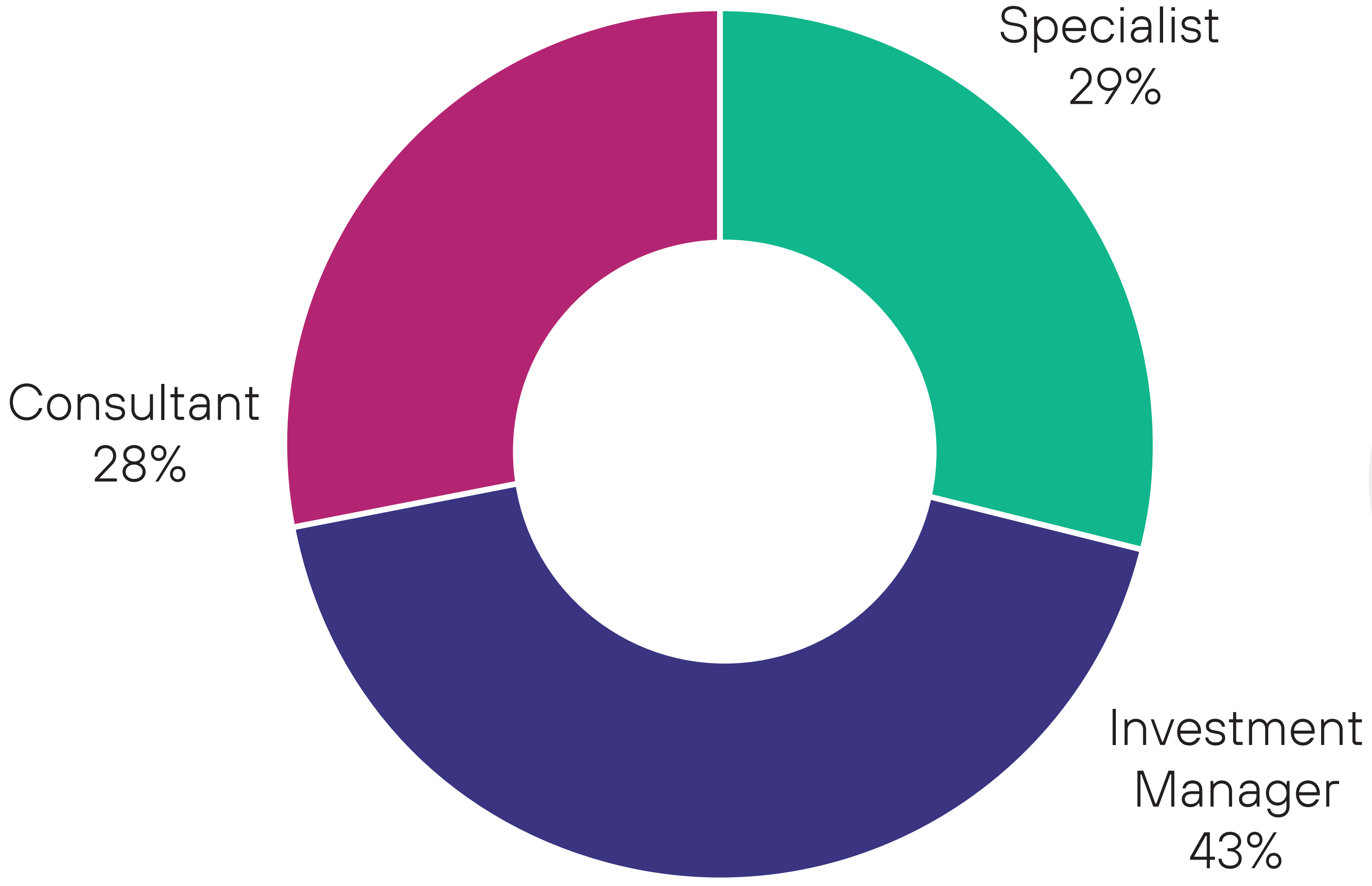
Consolidation of fiduciary providers in the market has had some impact on the overall provider composition in recent years and we expect this will continue to do so in future. Investment managers appear to have had greater relative success at winning large OCIO mandates compared to other provider types, which has increased their AUM.

Reflecting on how DB pension schemes have evolved over the last 2 years, more trustees may be looking to consider an alternative investment governance option that meets the needs of their scheme. For example, for a scheme which is now well-funded, targeting a low investment return, an alternative governance model or a different style of fiducary management approach, may be more appropriate. The changing demand for different assets classes and capabilities, may influence the market composition of FM providers in future.

Number of Fully Delegated Mandates by Provider Type



Fully Delegated AUM by Provider Type



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Governance

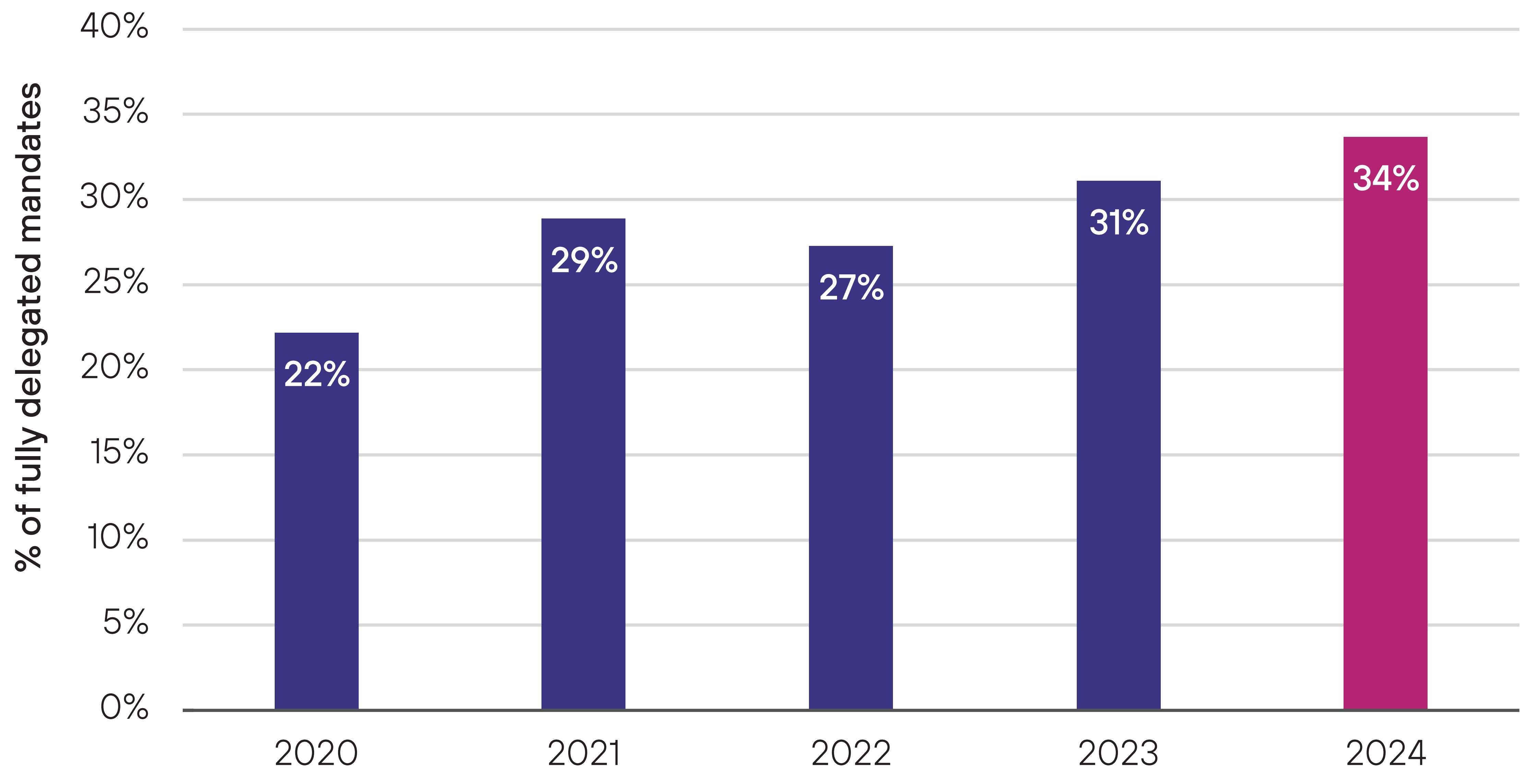
A marked increase in the use of independent governance across FM mandates

There has been a steady increase in the number of mandates which use independent advice in their ongoing oversight – increasing from 22% in 2020 to 34% in 2024.

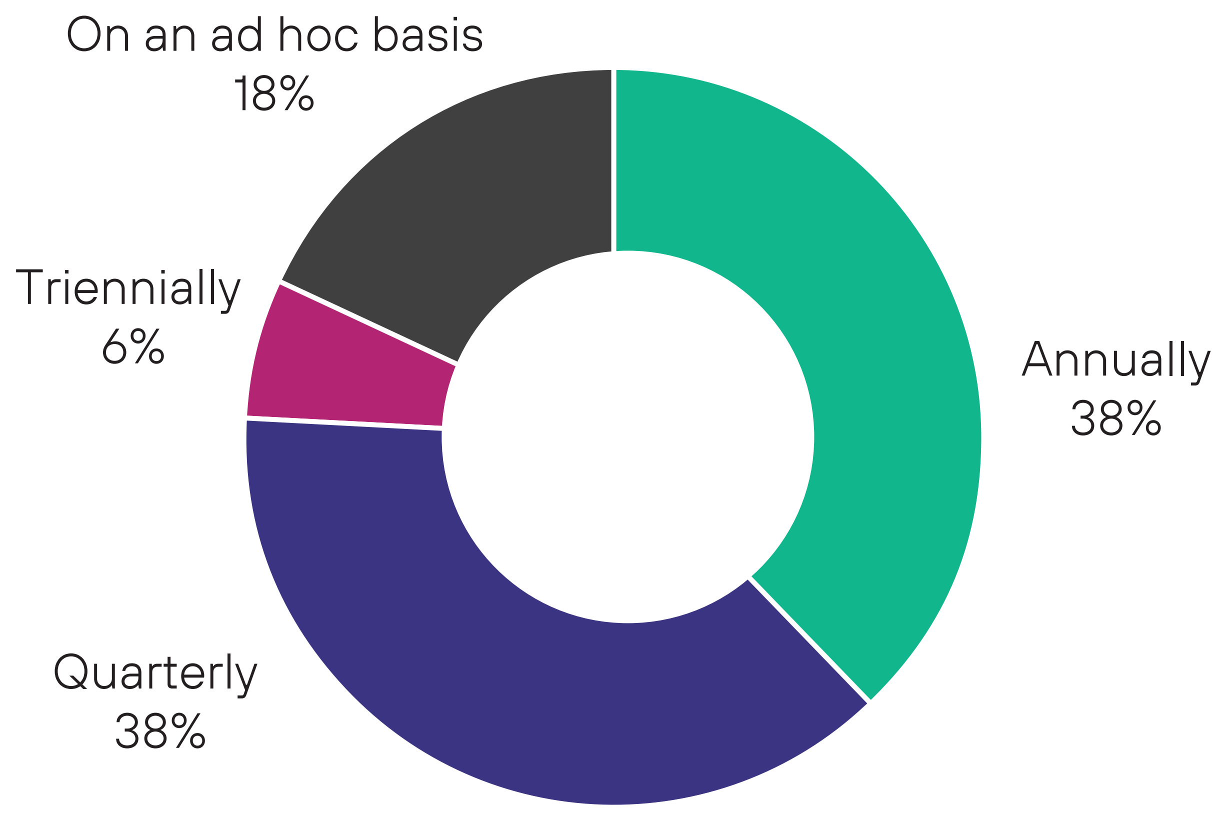
Over one third of fully delegated mandates have a Third-Party Evaluator ("TPE") in place. The frequency of engagement is evenly split between quarterly and annual reporting (38% each). The remaining 24% of schemes engage on a triennial (6%) or ad hoc (18%) basis.

We see this as a positive change – increased oversight in the market to evaluate actions taken by fiduciary managers can enhance the quality of Fiduciary Management as a whole.

Use of TPE to Monitor FM Mandates



Trustee frequency of Engagement with their TPE



For the first time, over one-third of fully delegated mandates now use some form of oversight.

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Governance

There appears to be a slight preference in the FM market for the use of professional trustees, with 58% of those schemes having a professional trustee in place.

Schemes using FM are more likely to have a professional trustee

For the first time this year we also enquired about the use of professional trustees for fully delegated mandates.

We believe schemes using fiduciary management can benefit from a goverance arrangement in which a professional trustee is appointed alongside a third-party oversight provider. This combination allows for a greater breadth of pension scheme expertise and experience, coupled with in-depth knowledge of the fiduciary market and broader investment capabilties. Both parties provide an additional layer of independent oversight and strategic challenge which is valuable for many schemes using fiduciary management.

The pace at which governance changes are being made following the “gilts crisis” has increased significantly, with many trustees reconsidering their schemes’ governance models. We have seen the increased use of the sole trustee model being conducive to a FM arrangement, where a more streamlined approach to governance is preferable. In our experience, we often see the benefits of oversight in this scenario, where challenge and monitoring of a FM provider can be welcomed.

“It is no surprise to us that sole trusteeship, the FM model and oversight have developed in tandem.”

Paula Champion, Head of Fiduciary Management Oversight

Number of Fully Delegated Mandates with a Professional Trustee ("PT") in Place

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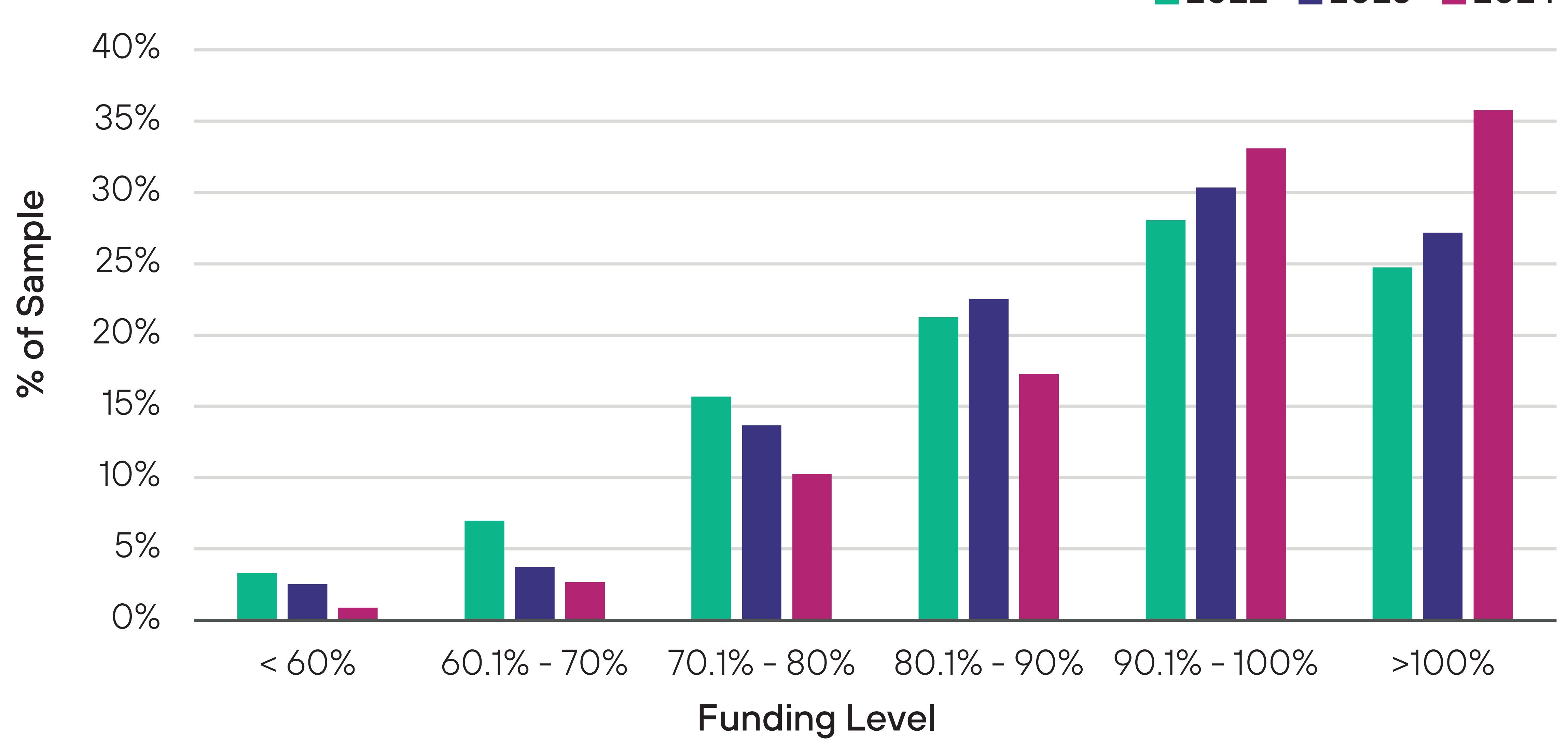
Long-Term Objectives

Schemes using FM improved their funding further this year

Over the past three years we have observed a marked increase in the funding levels of FM mandates on a Technical Provisions ("TP") basis. The number of mandates that are more than 90% funded increased by 11%, with more than a third of fully delegated FM mandates now over 100% funded on a TP basis.

This increase is unsurprising given the strong performance of growth assets over the year and the overall rise in gilt yields – but have fiduciary managers been evolving their solutions to meet clients' changing needs? The improvement in funding level is similarly reflected in the increase in the number of schemes that have de-risked, increased their hedging targets or have successfully completed an insurance transaction.

Funding Level Progression



Note: Sample data covers 78% of fully delegated FM mandates due to availability of data from the providers.

More than a third of fully delegated FM mandates are now over 100% funded on a TP basis.

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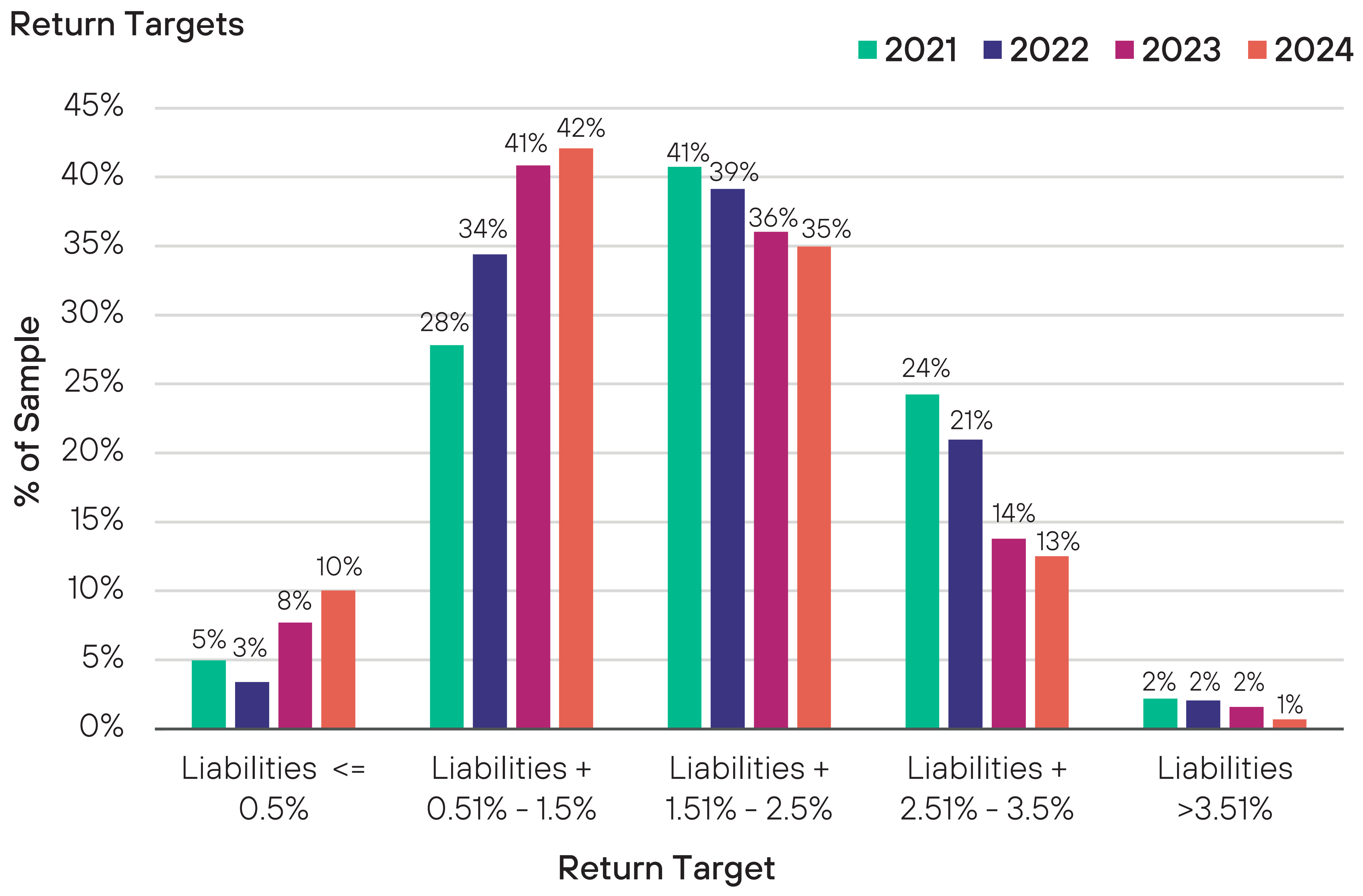
Long-Term Objectives

Return targets reduce further

We have observed an increasing trend in the number of mandates targeting lower returns, with 52% of the market now targeting a return of Liabilities +1.5% p.a. or below.

With increased importance placed on moving towards an efficient, low-risk portfolio, we have witnessed fiduciary managers focusing their research into alternative credit and cashflow-driven investment ("CDI") strategies to better service clients targeting lower returns. With this changing focus, the spotlight shifts to new capabilities across the providers, evolving client needs forces fiduciary managers to evidence different areas of performance, showcase risk management capabilities, and to refresh their propositions.



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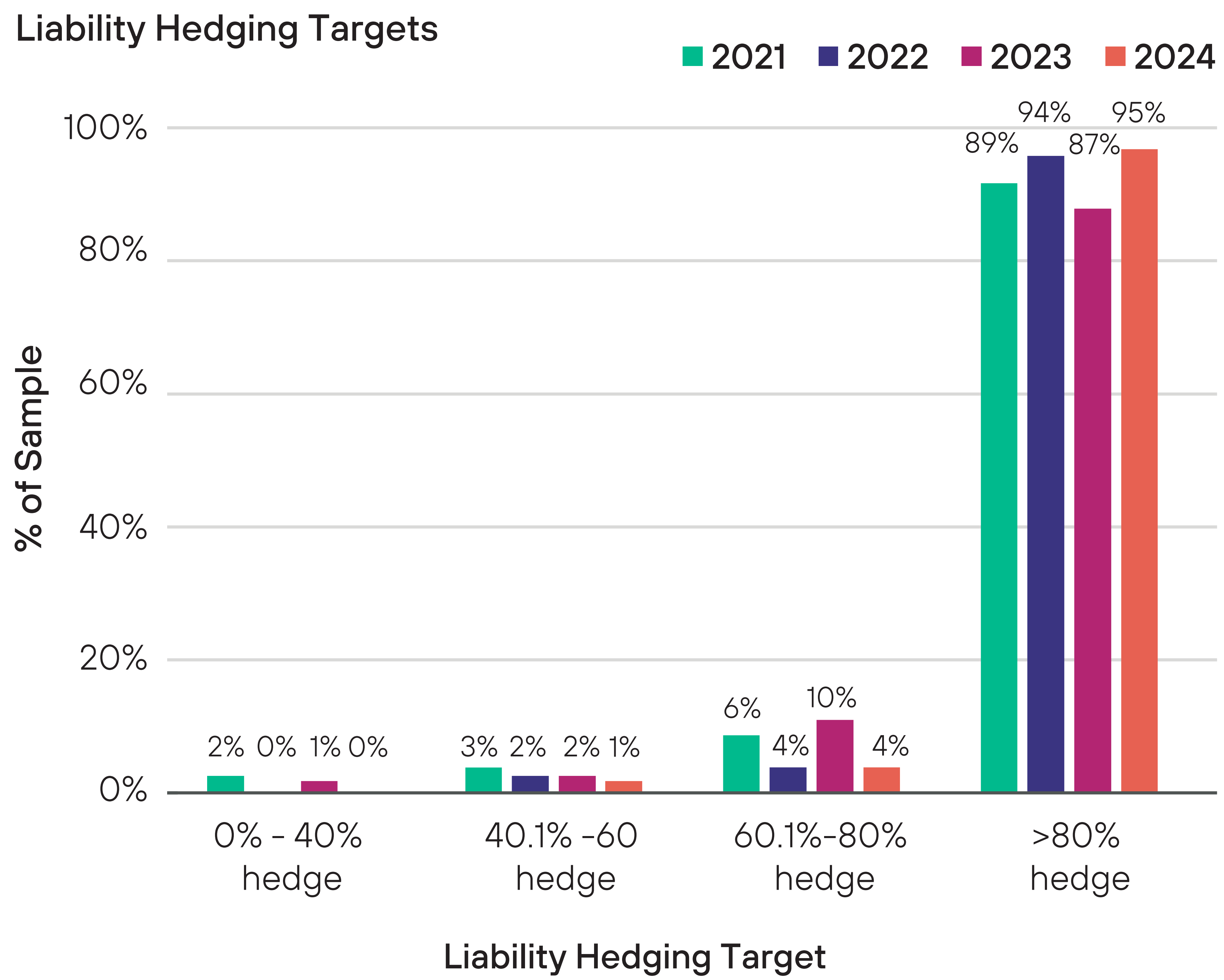
Long-Term Objectives

Liability hedging targets remain high

Straight after the "gilts crisis" at the end of 2022, liquidity constraints forced many schemes to reduce their hedging levels. This year we've seen a reversal, with more schemes than ever targeting higher hedging levels. It is clear that the efforts of the fiduciary managers to free up assets has been beneficial for many schemes. This includes initial disinvestments of illiquid holdings, the use of bond cashflows, and bespoke liability hedging.

While liquidity remains an issue for some schemes, we believe liability hedging and liquidity requirements have stabilised somewhat – albeit leading some trustees and fiduciary managers to take a more cautious stance.



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End-game Objectives

Insurance is the most popular objective for schemes using FM

In 2024 almost half of schemes using FM have set their end-game objective to carry out an insurance transaction. This is a new question in our survey and the results somewhat surprised us. With one-third of the market targeting run-on, and in light of developing regulatory regimes, we are intrigued to see how the fiduciary managers evolve their propositions as more schemes consider this objective. The FM solution will be different for schemes with differing objectives – insurance capabilities and illiquid propositions being the two main differentiators.

What capabilities should you look for in a fiduciary manager if considering...

Buyout

- De-risking framework
- Insurance capabilities
- Liquidity management

Run-on

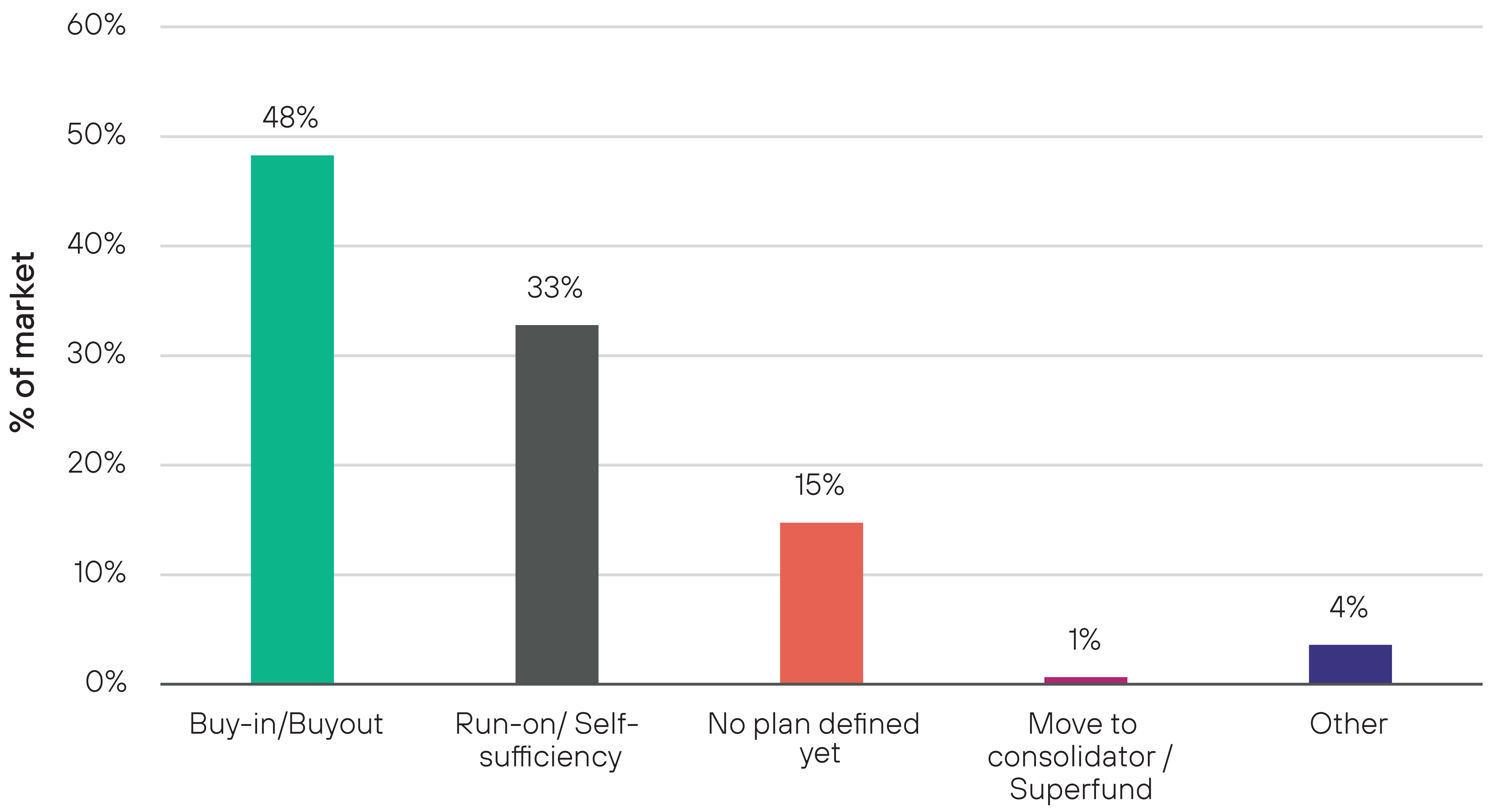
- Illiquid allocations
- Cashflow matching
- Surplus capture

Given stricter regulations set out by The Pensions Regulator, we anticipate the number of mandates without a stated end-game objective, currently at 15%, will fall significantly.

"If they haven't done so already, we would encourage trustees to have a discussion with their fiduciary manager about their scheme's end-game objectives and how their capabilities can help secure it."

Alex Owen, Head of Fiduciary Research

End-game objectives



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End-game Objectives

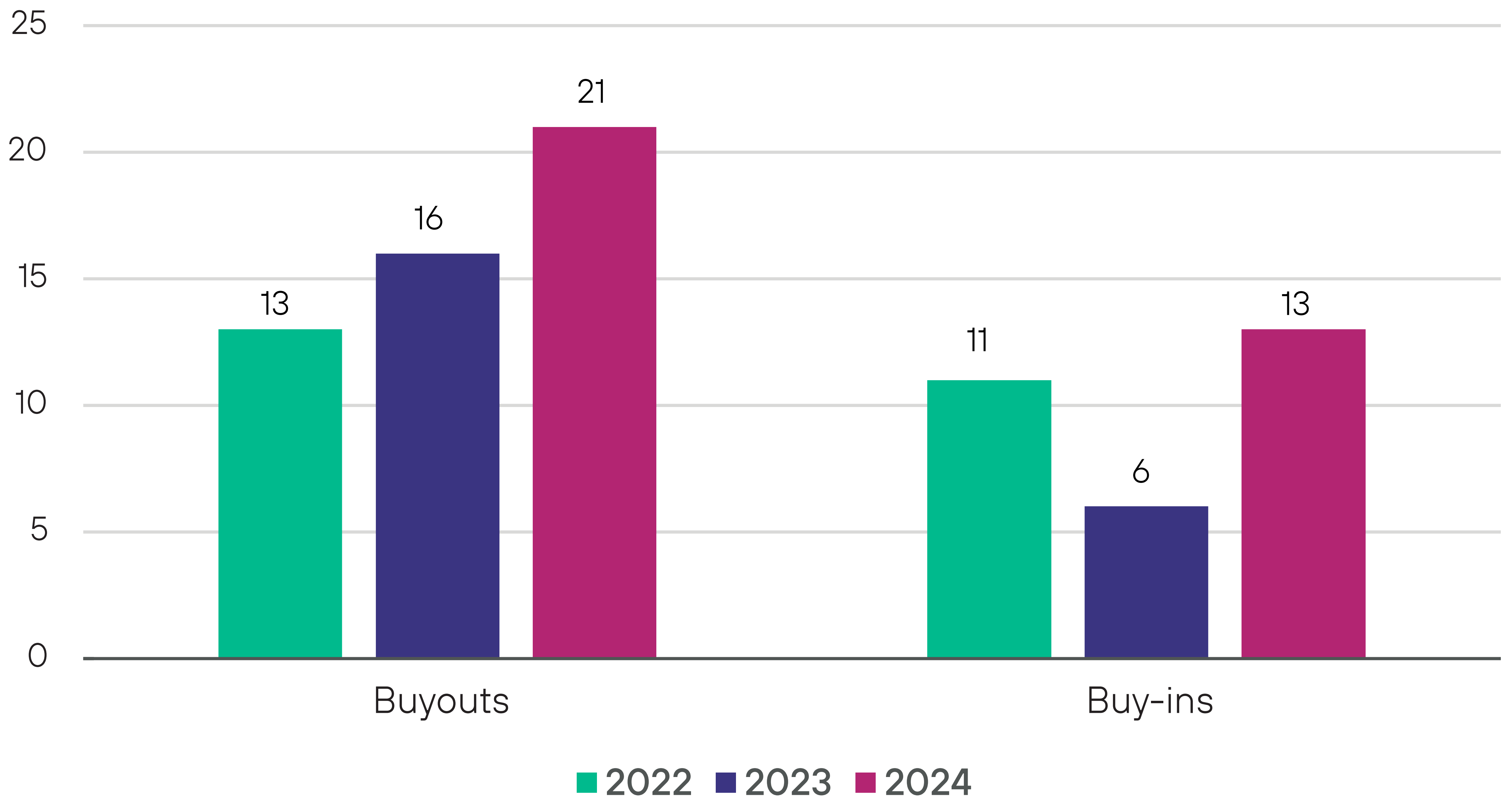
Insurance transactions continued to increase this year

The increase in insurance transactions does not come as a surprise given the improvement in funding levels. Over the past year we have seen a c.30% increase in the number of buyouts and more than a 100% increase in the number of buy-in transactions within the FM market.

This year we observed that a staggering 36% of mandates are now less than three years away from buyout (as opposed to 2023 where only 24% of mandates were in this position). We would anticipate the number of transactions to continue to increase in the coming years. With so many mandates looking to transact in the near-future, pressure on fiduciary managers to have a robust, tried and tested insurance proposition in place will increase significantly.

As more schemes move towards insurance transactions, we would flag to trustees the importance of fiduciary managers completing the pre-transaction 'housekeeping' activities and getting the scheme ready for buyout - so that the scheme is attractive to insurers when the time comes to transact. For example, discussing a plan for how any residual illiquid assets will be sold. We have produced an insurance checklist to support trustees with their preparation, if this is of interest to you, please do reach out to us.

Number of Insurance Transactions for Fully Delegated Mandates



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Asset Allocation Changes

Illiquid assets make a resurgence in FM portfolios

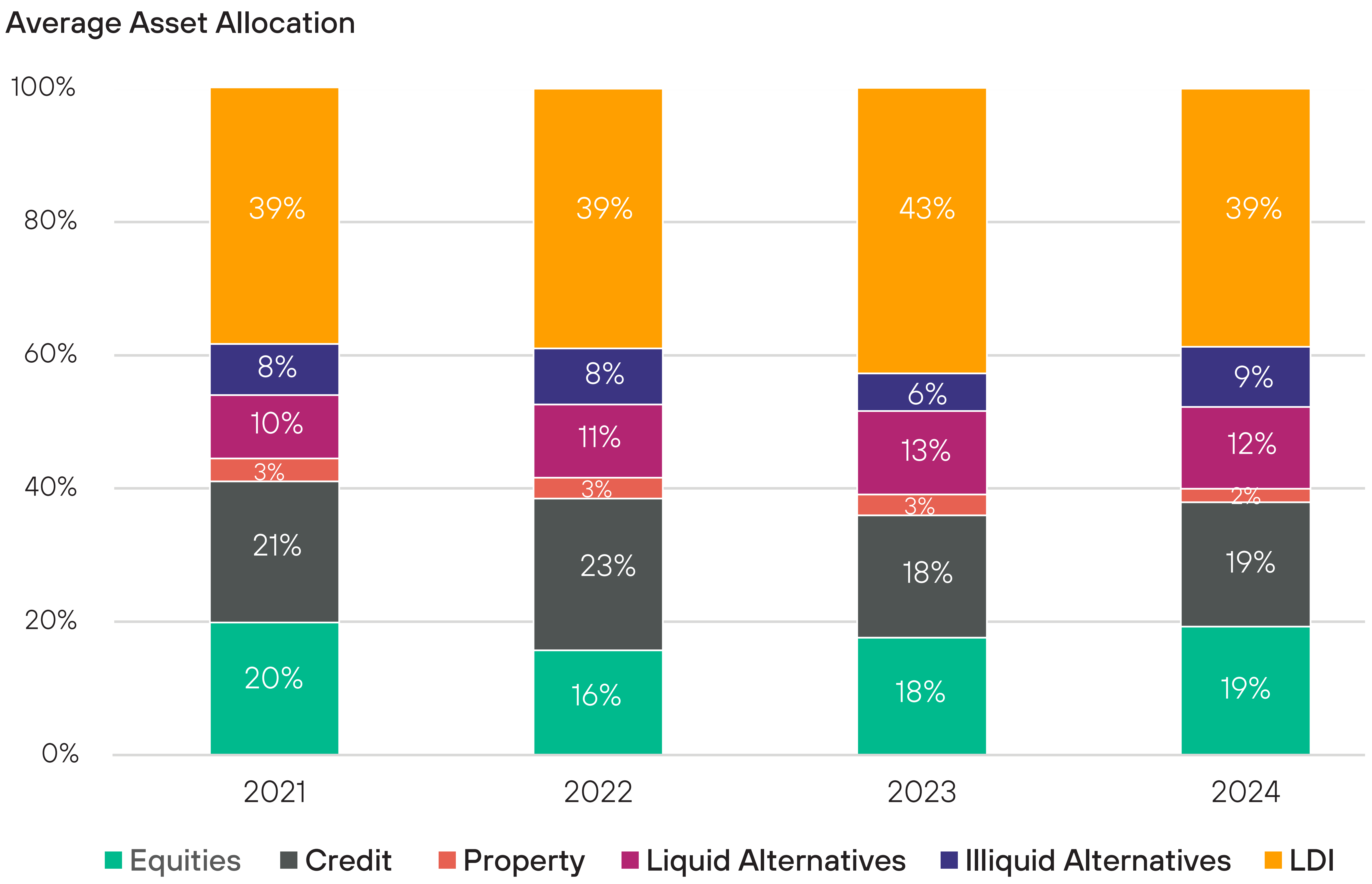
We asked fiduciary managers to tell us how they would invest the assets of a £500m scheme, targeting a return of Gilts + 2% per annum. The chart on this page is based on the average response.

Compared to 2023, we observed:

- More illiquid assets
- Less property
- Maintained liability hedging targets – but less collateral supporting them

The most noteworthy change is a 50% increase in the average manager's target allocation to illiquid alternatives. By contrast the liability hedging targets have generally been maintained, but the collateral assets supporting them have reduced.

This reallocation between liability hedging collateral and illiquid assets suggests there is improved confidence in the overall liquidity of the portfolios that the FMs manage. It also may be a feature of schemes who are looking to run-on, as those schemes will generally have longer time horizons that can withstand illiquidity. It places a greater emphasis on capabilities of managers to add value in private markets.



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Environmental, Social & Governance Factors

Reporting enhancements continue across fiduciary managers

We saw further improvement in the fiduciary managers' ability to provide ESG metrics on a scheme-specific level this year. This indicates there has been a significant amount of work continuing in this space.

Fiduciary managers can now provide the following scheme-specific data on a quarterly basis:

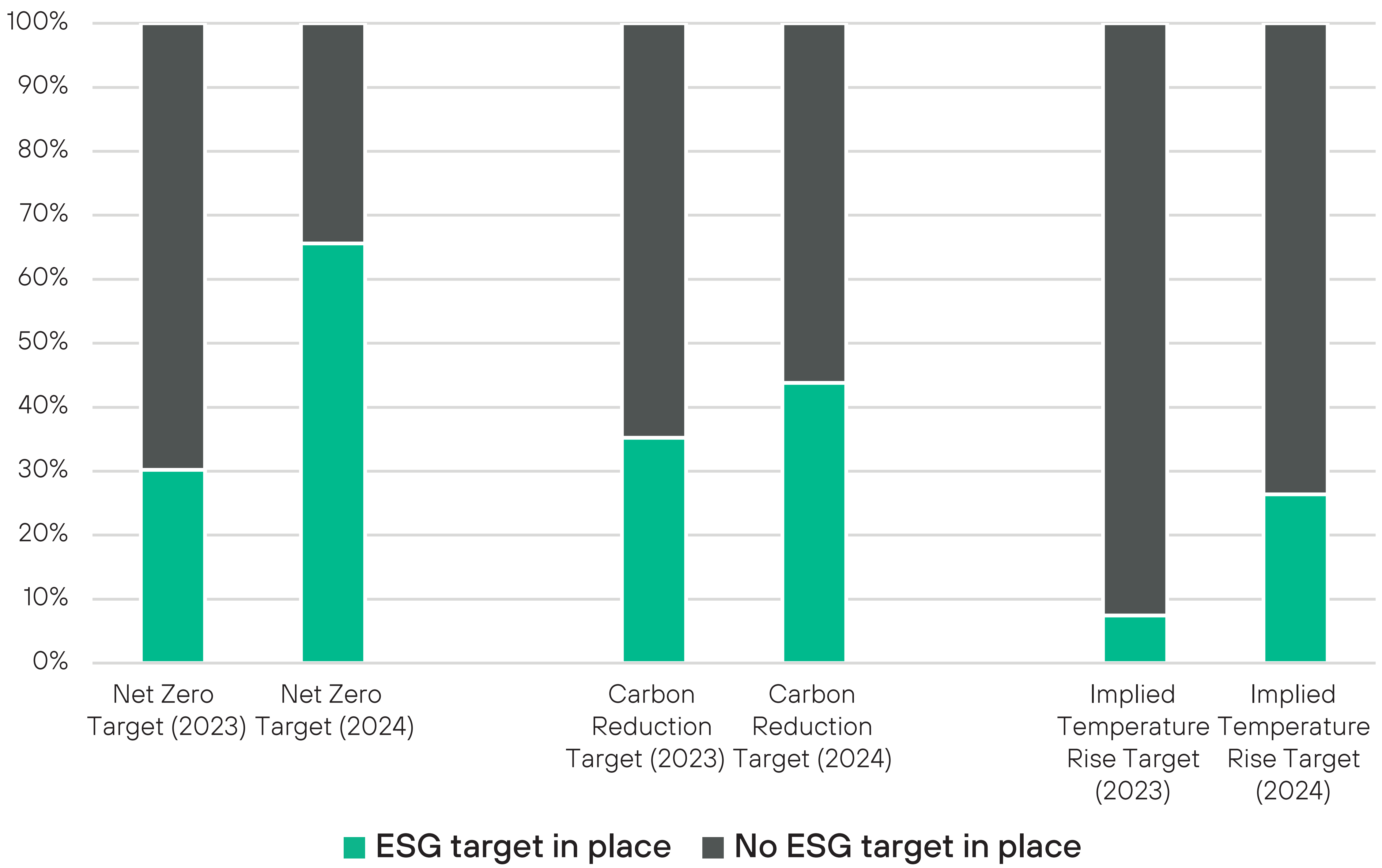
- Carbon emissions (scopes 1, 2, and 3) and footprint data: 70% (+17% vs. 2023)
- Implied temperature rise: 54% (+23% vs. 2023)
- Company Board gender diversity: 62% (+8% vs. 2023)
- CEO and Chair independence: 46% (+30% vs. 2023)

We think the improvement in manager reporting has come from significant investment across the asset management industry. We also believe that TCFD requirements for large schemes are having a "trickle down" impact for schemes of all sizes.

Two-thirds (66%) of fully delegated fiduciary mandates now have a net zero carbon emissions target in place, this has increased from 30% in 2023. Increases to carbon reduction and implied temperature rise targets also occurred but to a lesser extent.

We expect part of this increase to be due to managers aligning portfolios to their own firmwide commitments. These then become the new targets for the schemes that they manage under a fiduciary arrangement. It is however still important that, where schemes are using fiduciary management, that any changes made to ESG and climate objectives still align with the individual scheme's objectives.

% of Fully Delegate Mandates with ESG Targets in Place



We think the improvement in manager reporting has come from significant investment across the asset management industry.

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Fees

Average FM fees remain largely unchanged

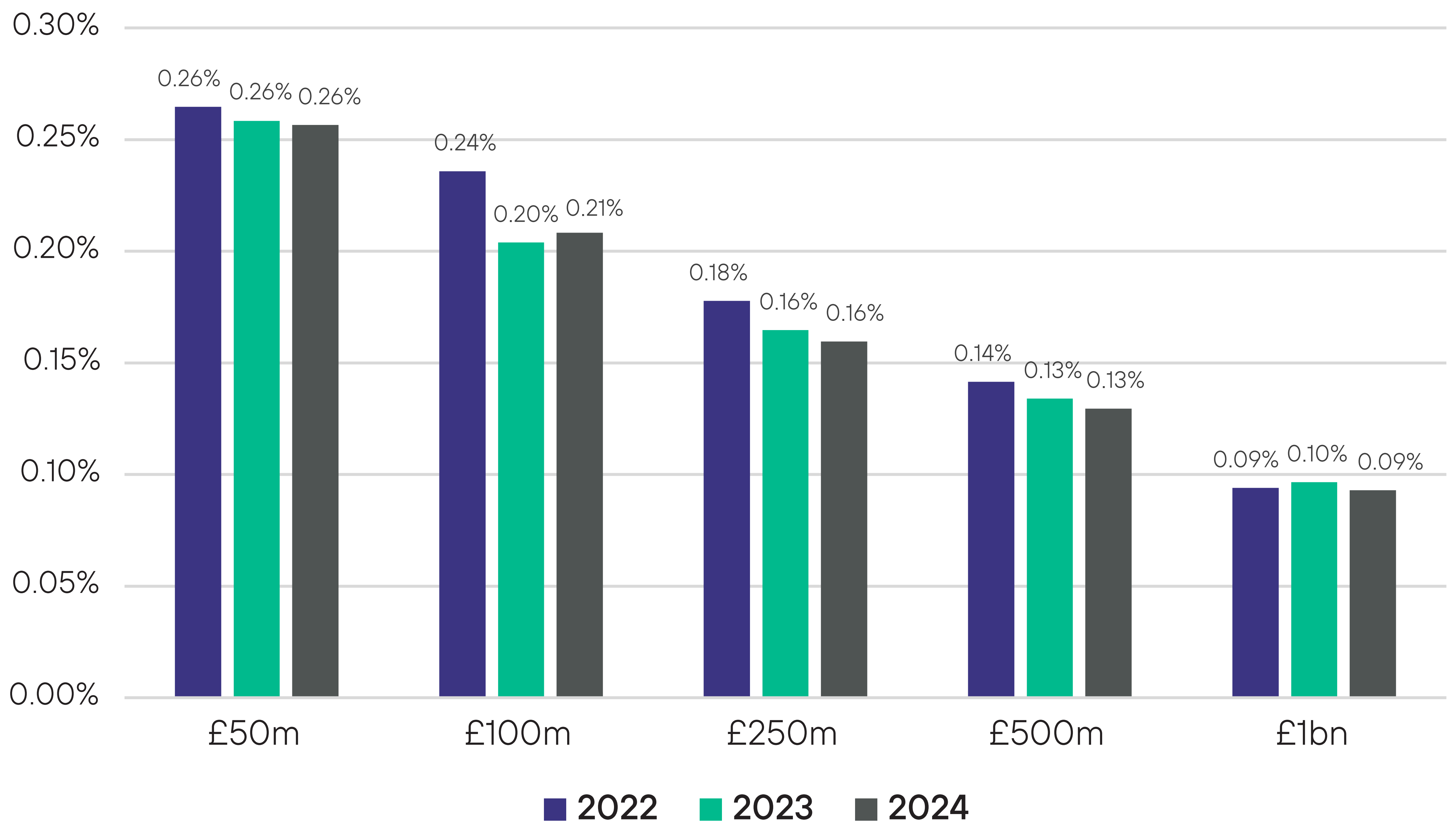
Each year we ask fiduciary managers what their "best ideas" FM fee would be for a scheme targeting a return of Gilts + 2% per annum, dependent on the asset size of the mandate.

Following a few years of FM fee reductions, driven by CMA retendering and increased market competition, fee changes have since become more stagnant. The rise in gilt yields caused the average scheme size to fall and we believe this has halted further declines in fees.

While the changes in average fees have slowed over the year, there remains a range of different fiduciary fee levels across the industry at all asset levels. We think there is still room for discussions between trustees and their managers on demonstrating competitiveness of their fee arrangements, and the value they add for each scheme.

Increased scrutiny and challenge on FM portfolios from independent oversight, combined with shifting scheme objectives (resulting in less complex portfolios targeting less risk and lower returns) should help to ensure trustees are getting good value for money from their FM arrangements.

Average FM Fee by AUM (Best Ideas Portfolio)



This year FM fees are relatively unchanged at all asset levels.

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Fees

Renewed debate over underlying manager fees and the value added

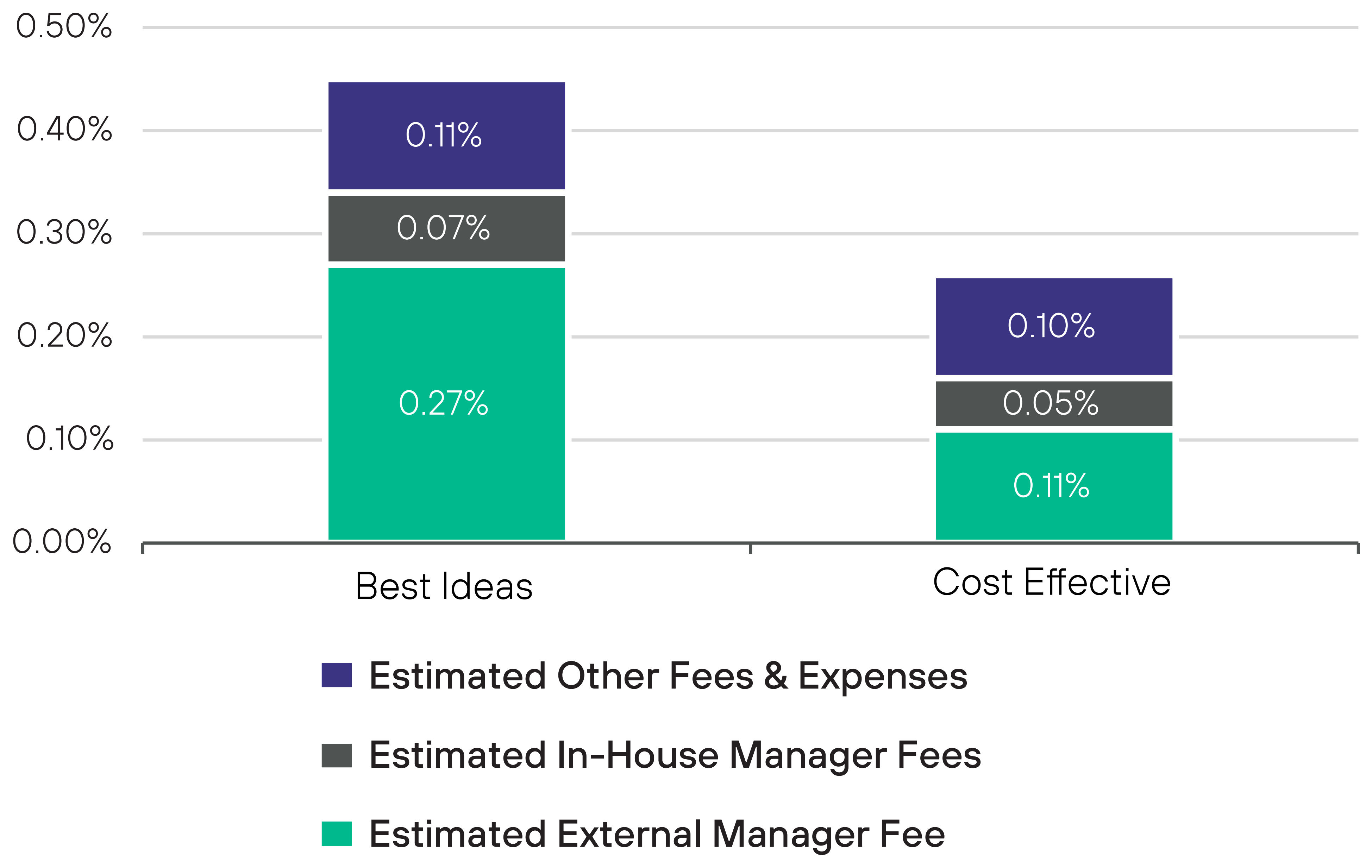
When fiduciary managers propose their "best ideas" portfolio to their clients, this will typically include the use of active management and more complex strategies. These are often associated with higher costs than a more passively managed "cost effective" approach.

The chart confirms the difference in average fee levels between best ideas and a cost effective approach. When these costs are compared with a mixed picture of performance from these strategies, it continues to spark debate. Does your fiduciary manager's "best ideas" investment strategy add enough value over time to warrant paying the additional costs? In our experience there is not necessarily a pattern between high fees and greater risk-adjusted performance – albeit this depends heavily on the provider, the asset class and funds you are invested in and the period you analyse performance over. For example, a certain market environment might not be conducive to a particular asset class performing well. This could support persisting with a "best ideas" portfolio in the wake of poor performance.

As funding levels improve gradually over time, we receive a lot of questions from trustees and company sponsors on whether the "best ideas" portfolio remains valuable when target returns are lower. The focus may turn to relatively simpler strategies, or require managers to demonstrate they can still add value in other ways. Isio continues to work with many of our clients to assess value for money for the fees they are paying.

In our experience there is not necessarily a pattern between high fees and greater risk-adjusted performance

Average Best Ideas Fees vs Average Cost Effective Fees



For a £100m scheme this is a total cost of:

Best ideas = £450k p.a.

Cost effective = £260k p.a.

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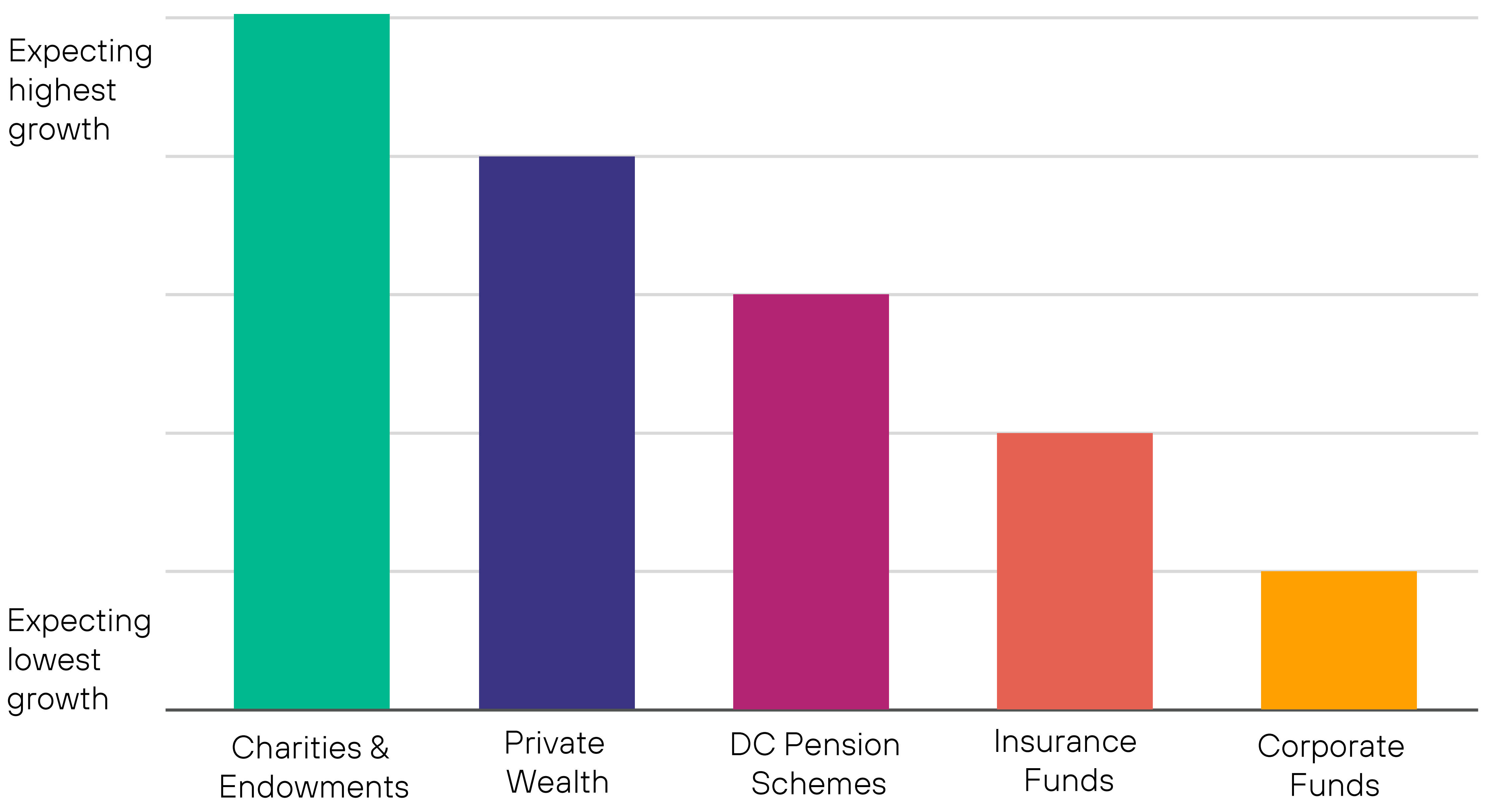
Beyond Pensions

Delegation of investment decisions to a fiduciary manager is extending beyond Defined Benefit pension schemes

The chart shows how fiduciary managers expect the broader opportunity set of clients to evolve over the next five years. Charities and Endowments are expected to grow the most. This is consistent with what we have heard from a number of FMs who have told us they have been growing their client base in this area over recent years.

With growth in the UK DB market slowing and competition remaining high, we think it is natural for fiduciary managers to expand into other market segments. When exploring other market segments we expect FMs will consider new investment ideas and enhance their proposition to meet the needs of non-DB clients. We also expect there will be opportunities for existing mandates to leverage these new ideas where relevant.

Where do FMs see the most growth in the non-DB market over the next 5 years (ranked)?



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Isio and Fiduciary Management Advice

Fiduciary management expertise

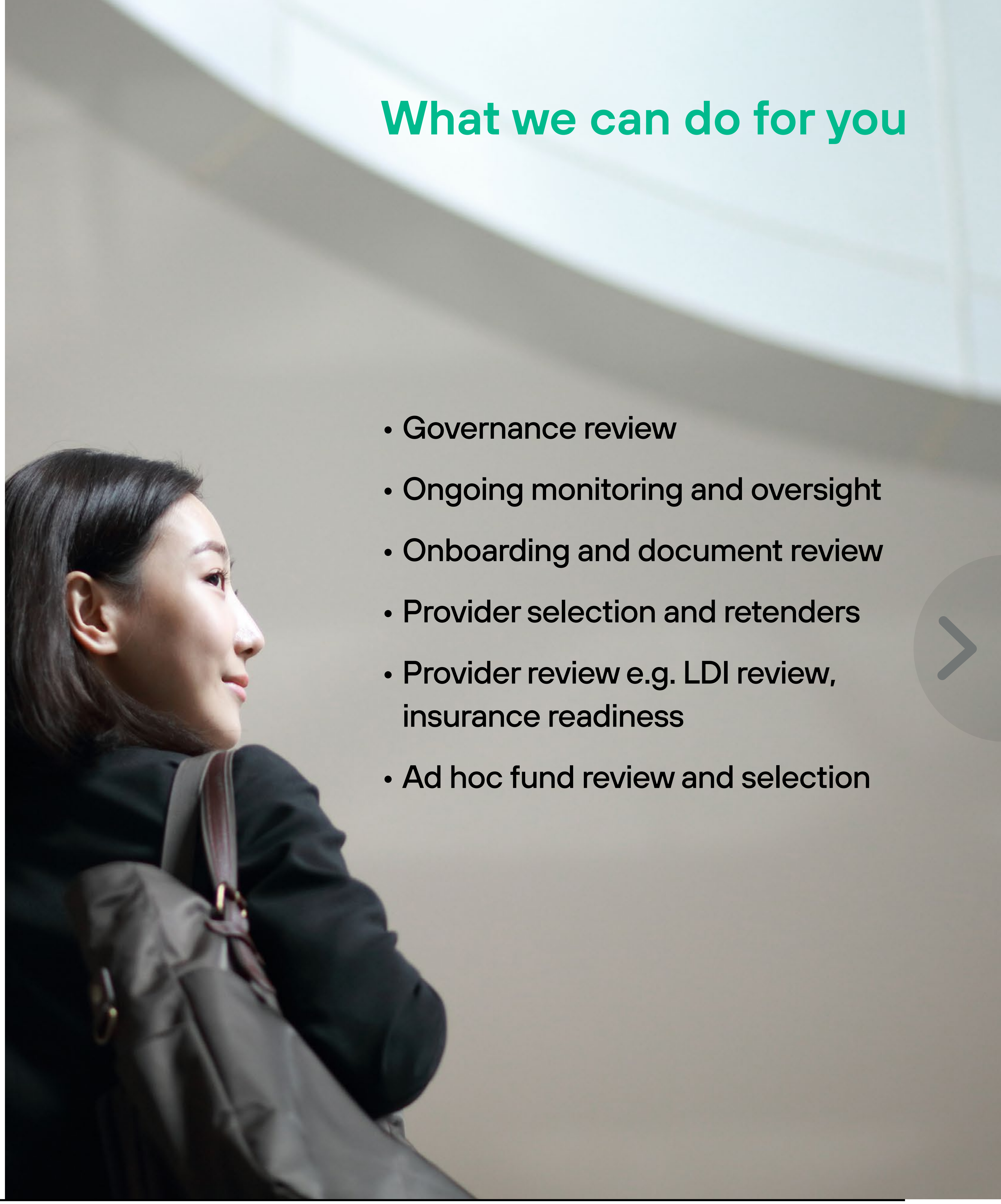
We provide ongoing independent fiduciary oversight to clients ranging from less than £20 million in size to over £10 billion.

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 £300 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 we can do for you

- Governance review
- Ongoing monitoring and oversight
- Onboarding and document review
- Provider selection and retenders
- Provider review e.g. LDI review, insurance readiness
- Ad hoc fund review and selection

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Further Notes

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 2024.

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
- Brightwell
- Cardano
- Charles Stanley
- Goldman Sachs Asset Management
- Legal & General Investment Management
- Mercer
- Russell Investments
- Schroders
- SECOR Asset Management
- SEI
- State Street Global Advisors
- Van Lanschot Kempen
- 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.

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Environmental, Social and Governance ("ESG"):

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 2024.

Coverage is defined as the proportion of funds invested in that will provide ICSWG and TCFD metric data.

More guidance on metrics data can be found here:

ICSWG Metrics   TCFD Metrics

Buy-in
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.

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

Run-on
A scheme continues to operate and pay out expenses and benefits to members as they fall due over time, fulfilling pension obligations with no or 'low dependency' on the sponsoring employer.

Fees:

External manager fees: Fees paid to any externally managed funds, including any performance-related fees.

In-house manager fees: Fees paid to the Fiduciary manager for any in-house managed funds, including any performance-related fees.

Other fees & expenses: Includes custody, audit and any other operational/ancillary fees. Excludes any initial and ongoing transaction costs.

Pooled LDI
Pooled funds work similar to mutual funds, grouping the capital of multiple investors to deliver a standardised hedge solution.

Segregated LDI
Segregated funds deliver a bespoke hedging by purchasing credit instruments, which mature at the same time as future cashflows are due to be paid to members.

Provider types in the UK market:

Consultant
Business heritage of providing a range of pension and financial consulting services.

Investment manager
Business heritage of providing asset or wealth management services.

Specialist
A firm where fiduciary management forms a significant proportion of ongoing business activities.

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