New Perspectives on Fiduciary Management

Table of Contents

Introduction

This booklet aims to make a contribution to the world of pensions by presenting new perspectives on fiduciary management. The occasion for making this booklet is the WorldPensionSummit 2011 in Amsterdam, where I am speaking on 'the next generation of fiduciary management'.

Several respected pension professionals with a broad range of backgrounds have been invited to offer their latest insights and their experiences with the fiduciary management model. I would like to take this opportunity to thank all of them for kindly contributing to this booklet by offering their thoughts on the topic.

My personal contribution is an article about what I believe are the 5 key principles of fiduciary management. Furthermore I share my vision on what the next generation of fiduciary management looks like.

My article has benefited from a large group of people, of whom I like to thank the following in particular. Keith Ambachtsheer has had a big impact by sharing his ideas with me while I was writing. Invaluable input has also been provided by Pieter Kiveron of the Holland Financial Centre and my colleagues Remco van Eeuwijk, Hein Stam, Jeroen Trip and Parisa Veldman-Koops of Mn Services.

A number of articles have benefited from the assistance of Nigel Birch of Spence Johnson. Special thanks goes out to my colleague Lars van Dort without whose efforts this booklet would not have been possible.

I hope this booklet succeeds in being inspirational by providing new perspectives on fiduciary management!

Wouter Pelser

Rijswijk, November 2011

Keith Ambachtsheer,
KPA Advisory Services and University of Toronto's Rotman International Centre for Pension Management

Over 400 years have passed since the Dutch invented the modern corporation with its limited liability and tradable shares features (i.e., the VOC in 1602). Today they are leading the world in inventing another important social construct: an affordable, sustainable 21st Century pension design and delivery system that permits people to maintain a decent standard of living after they stop working.

Dutch Thought-Leadership in Pension Design and Delivery

The new Pension Accord takes the country a number of steps in the right direction. For example, it focuses on achieving standard of living targets rather than nominal guarantees. It recognizes that changes in longevity need to be factored into the calculation of pension benefits. It recognizes that most people would welcome some flexibility in choosing their retirement date. Of course, more work needs to be to complete the Accord. For example, should the new design not recognize that 25 year-olds and 85 year-olds don't have the same tolerance for taking investment risk? Is it not true that these differing risk appetites can only be accommodated by providing participants with separate return-seeking and risk-shedding investment instruments, with the young favoring the former, and the old the latter? Does accommodating these differing needs destroy solidarity, as some people suggest? Or does it do quite the opposite: enhance it?

The Dutch are also experimenting with the structure of pension delivery organizations, with the 'fiduciary management' model taking over center stage. To the degree smaller pension plans seize the resulting opportunity to delegate the management of their pension plan to a larger, more expert and cost-effective 'fiduciary manager', they will likely serve their plan members well. However, these new structures do have embedded risks of their own. Plan fiduciaries must also ask how the 'fiduciary manager' model benefits the members of the plan from which the 'fiduciary manager' was created in the first place. Do these originating plan members benefit from lower operating costs, for example, as scale increases? Or, instead, are they merely saddled with additional marketing expenses as the 'fiduciary manager' gears up to attract new third-party business?

I believe the long-standing Dutch tradition of seriously researching and debating these important pension design and delivery questions will continue in the years and decades ahead. As a result, I predict the Netherlands will continue to rank #1 in the Melbourne-Mercer Global Pension Index for many years to come.

Wouter Pelser,
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Today's Challenging and Complex Pension World

Pension scheme trustees have a challenging and complex job these days. Many schemes suffer from declining funding ratios: the global financial crisis has left its mark, interest rates have fallen significantly and participants are growing older than expected. In many markets, trustees face tougher regulations and increasing scrutiny from supervisory authorities.

The Next Generation of Fiduciary Management

Wouter Pelser (1968) has been a major force in building the fiduciary management model at Mn Services. He joined Mn Services in 2001 and currently is Director of Fiduciary Management. As such he is responsible for Account Management and Client Portfolio Management for

Corporate sponsors are increasingly burdened by increasing deficits and contributions while trying to manage their core business through a challenging economic environment. Participants are worried about their pensions.

The challenges do not stop there. Many countries are searching for a more suitable pension plan design and the way risk is shared between members and corporate sponsors. In general pension plan formulas are shifting to one where there is less risk being borne by corporate sponsors and less risk being shared collectively

Mn Services' Dutch clients as well as Investment Research and Responsible Investment. Wouter is also Chief Investment Officer. In that capacity he is responsible for the dynamic asset allocation process and chairs the Investment Committee. Before joining Mn Services, Wouter served as manager at a medium-sized pension scheme and as investment specialist at an insurance company. Wouter holds a Master's degree in Economics from the University of Amsterdam. He is a Chartered European Financial Analyst (CEFA). Wouter is in the process of obtaining an executive degree at INSEAD.

among members.[1] These changes give rise to new challenges.[2] In this landscape, what the world of pensions needs most is thought leadership and analytical power. In this article I will argue that fiduciary management can help provide and facilitate this and that a fiduciary manager can therefore play an important role as a strategic partner for trustees in solving the challenges that lie ahead.

The Rise of Fiduciary Management

About ten years ago the first fiduciary mandates were awarded in the Dutch market. By now a large majority of Dutch pension scheme assets are managed using the fiduciary management model.[3] More recently the concept has been successfully introduced in other countries, most notably in the UK, but also in Germany, Italy, Australia and Japan. However, so far the market share of fiduciary management outside the Netherlands is still relatively small.

The concept of fiduciary management has evolved over the years, having been improved and adapted based on experience, market developments and a changing regulatory environment. And it is still evolving today. I believe that the next generation of fiduciary management is about to arrive. Or, perhaps it is already here!
I am aware of the fact that many different kinds of propositions in the market by now use the label 'fiduciary management'. While nobody owns the definition of fiduciary management, one can question whether all parties who use the label fiduciary management are really offering this. I will try to help create more clarity by sharing my vision on fiduciary management in this article.

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[1] OECD, Pension Markets in Focus, July 2011 (8).

[2] Keith Ambachtsheer, Pension Revolution: A Solution to the Pension Crisis. Wiley Finance, 2007.

[3] An estimated 82% of all Defined Benefit pension assets in the Netherlands is under fiduciary management according to Fiduciary Management Market Insight, March 2011 by Spence Johnson.

The Five Key Principles of Fiduciary Management

Before delving into what the next generation of fiduciary management looks like, let us first take a look at what fiduciary management is exactly.

Fiduciary management is a governance solution.

In my view, fiduciary management is a governance solution that supports trustees with a holistic approach to the management of pension assets relative to the pension scheme's liabilities. Its primary aim is achieving the scheme's long-term goal in a risk-controlled and cost-effective manner.

I believe fiduciary management can be defined by five key principles that create the value of the proposition. These principles are:

1. Dynamic balance sheet management
2. Putting trustees in real control through good governance
3. Holistic approach
4. Transparency and aligned interests
5. Benefits of economies of scale

1. Dynamic balance sheet management

It is the focus on the integrated balance sheet that sets the fiduciary manager apart from the asset manager.

The first key principle is dynamic balance sheet management. It is the focus on the integrated balance sheet that sets the fiduciary manager apart from the asset manager. A true fiduciary manager will always take the liabilities as the starting point for the management of the assets. In order to meet the funding objective, the discussion about the strategic investment objective must start with an analysis of the liabilities. While the fiduciary manager can provide information and advice (e.g. through an asset-liability management study), in the end the funding objective and the strategic investment objective that is consistent with that funding objective are set by the trustees. The trustees and the fiduciary manager will then determine a risk budget and an investment strategy that consists of a strategic risk profile for the balance sheet. The fiduciary manager then implements the trustees' strategy on an integrated basis.

But the work is not done when the strategy is implemented. The balance sheet then needs to be managed dynamically. An investment strategy should never lead to a fixed allocation, even if it can be updated regularly. The world and certainly financial markets can change quickly and while pension schemes are long-term investors, a simple buy-and-hold strategy cannot be optimal for the whole portfolio. The investment plan should be designed to give the fiduciary manager a mandate to dynamically change the risk level and profile in response to developments in the markets, changes in economic outlook and changing funding level. This flexibility for the fiduciary manager enables the pension scheme to always benefit from the highest expected return per unit of risk possible. Of course, the trustees always have the final say in the overall strategy and should decide to what extent they feel comfortable delegating the exploitation of opportunities for dynamic asset allocation to the fiduciary manager and at what point it wants to be involved in the decision-making process.

2. Putting trustees in real control through good governance

A second principle is to put trustees in real control by putting in place an effective governance structure. While the trustees can delegate many day-to-day activities to the fiduciary manager, they have to stay in control. In most countries this is even their legal obligation.

One way to be in control is that they take all decisions themselves. But in most cases trustees have neither the time nor the expertise to take all decisions. If that is the case, then the trustees are only in theoretical, but not in real control. Hiring additional resources that have the time and expertise to help the trustees set the strategy and to take the non-strategic decisions will actually strengthen control. And this is what fiduciary management offers.

Fiduciary management puts trustees in real control.

The fiduciary manager therefore has an important responsibility to guide the trustees with information, advice and policy proposals to help them set, monitor and update the strategy. This is what I call facilitating trustees in fulfilling their fiduciary duties. And while delegating certain decisions can therefore enhance control, it is important that trustees have maximum decision freedom. The fiduciary manager must therefore be able to offer a customised solution that takes into account the preferences and requirements of the trustees.

Sometimes it is claimed that fiduciary management means delegating 'everything'. This could not be further from the truth.

In my vision of fiduciary management, the setting of the strategy is never delegated and the implementation of the strategy is always delegated in a controlled manner with various check and balances, bandwidths and limits.

The fiduciary management model itself can be seen as a governance solution for trustees to support them in handling the increasingly complex pension world. A fiduciary manager simplifies and improves the management of the pension scheme significantly by supporting trustees with information and advice on setting the investment strategy and then implementing all aspects of that strategy accordingly. The result is an effective governance structure with clear accountability and trustees in real control. The trustees do not have to deal with many different parties anymore, none of which would take any true interest in and responsibility for achieving the overall goals of the scheme.

The result is an effective governance structure with clear accountability and trustees in real control.

The fiduciary manager also has a responsibility to put in place the best possible governance structure within his own organisation. This governance structure of the fiduciary manager can be optimised by looking for the best possible alignment of interests with the client and ways to help trustees to be in control.

3. Holistic approach

Fiduciary management is a successful model because it takes the holistic approach and always has the overall strategic objective in mind. The holistic approach is a next defining principle of fiduciary management.

In the traditional model trustees outsource different aspects of the investment process to different specialists. These specialists only perform the task delegated to them, not necessarily taking into account the overall goals of the scheme. The coordination of all the aspects with the overall goals of the scheme in mind remains the task of the trustees. This is a burden for them, particularly in an increasingly complex environment, as they do not always have the information, expertise and time to fulfil this task effectively.

The fiduciary manager acts as a caretaker of the scheme's interests.

In the fiduciary management model, the fiduciary manager acts as a caretaker of the scheme's interests. It advises the board of trustees on strategy, takes responsibility for its implementation and is accountable for the results to the board of trustees. The fiduciary manager is responsible for managing all aspects of the scheme's investment process in accordance with the scheme's investment strategy and plan. The investment process can be thought of as a chain that consists of several interconnected links such as asset-liability management study, strategic investment advice, manager selection, overlay management, cash management, administration, responsible investment and voting, dynamic asset allocation, performance measurement and reporting. Each of these links involves specialised service providers.

The fiduciary manager's core responsibility is to ensure that each individual link and the investment process chain as a whole is solid and reliable at all times, thus maximizing the scheme's expected return after fees per unit of risk and ensuring that the level of risk throughout the chain is consistent with the scheme's investment strategy. This requires continuous monitoring and management of the chain on an integrated basis.

The whole can be more than the sum of the parts.

It is this idea that the whole can be more than the sum of the parts that is an important value driver of the fiduciary management proposition.

4. Transparency and aligned interests

The next key principle of fiduciary management is transparency and aligned interests. Both transparency and aligned interests are in my view necessary conditions for creating a strong strategic partnership between the pension scheme and the fiduciary manager. It is crucial for trustees to have good insight in what is happening particularly in the fiduciary model, where the pension scheme delegates the full implementation of the strategy. It is equally important that the fiduciary manager is driven by the same interests.

Transparency is a guiding principle in many areas of the fiduciary management model, such as governance, costs and reporting. It should be as transparent as possible how the governance between the pension scheme and fiduciary manager is shaped, how processes within the organisation of the fiduciary manager are arranged and who is responsible for what. Transparency also matters for costs. The fiduciary manager pursues as much openness in its reporting of costs as is reasonably possible. A pension scheme may choose to participate in an internationally recognized and independent cost measuring benchmark, which can give further insight and make costs comparable with those of peers.

A last example where the fiduciary manager distinguishes himself is transparency in reporting. Reports are accurate, complete, relevant and delivered on time, providing the trustees with true insight and (as always) facilitate them to be in real control. While I consider transparency a key principle and a strength of the fiduciary management model, I do believe there is still room for improving the quality of reporting in the fiduciary management industry. Trustees should not be afraid to demand this higher quality, thus benefiting more from the knowledge that the fiduciary manager possesses.

There is sufficient evidence that aligned interests improve investment results.

The alignment of interests between the pension scheme and the fiduciary manager is closely linked to transparency. Aligned interests matter for the simple reason that there is sufficient evidence that aligned interests improve investment results.[4] It has been suggested that this is because with the right alignment of interests, the motivation to benefit from informational asymmetries disappears. Such informational asymmetries will always to some extent exist between the pension scheme and their service providers. A survey among pension schemes trustees showed that 74.3% agreed or fully agreed with the statement that fiduciary managers have to take care of maximum mitigation of the knowledge and information asymmetry between themselves and pension scheme trustees.[5] Of course, the fiduciary manager already strives to minimise these informational asymmetries by using transparency as a guiding principle.

[4] See for example The Ambachtsheer Letter #297, October 2010 for an overview and Rob Bauer, The Performance of US Pension Funds: New Insights into the Agency Costs Debate, Rotman ICPM Working Paper, April 2007.

[5] Deloitte, March 2011.

5. Benefits of economies of scale

The last principle that is crucial for the concept of fiduciary management is that the fiduciary manager has to be able to deliver benefits of economies of scale to his clients. It is an important part of the value of the proposition.

Fiduciary management is very much a network model.

Some obvious benefits of economies of scale are the access to asset classes and managers that would otherwise be out of reach and the ability to negotiate lower fees with external managers. Fiduciary management is very much a network model: a good fiduciary manager offers access to a strong network of third parties that he maintains strategic relations with.

A further obvious benefit of economies of scale is the ability to offer lower fees for internal asset management.

There are also benefits of a different nature that the modern fiduciary manager should be able to deliver to his clients. In short, these are benefits that come from the experience of serving multiple clients. Such benefits can be found in all the links of the investment process chain. Lessons learned from serving one client can be applied when serving other clients. This ability to leverage on skill, innovation and experience is a very attractive feature of the fiduciary management proposition. It is absent for schemes that have an in-house team and because of that only have their own experience.

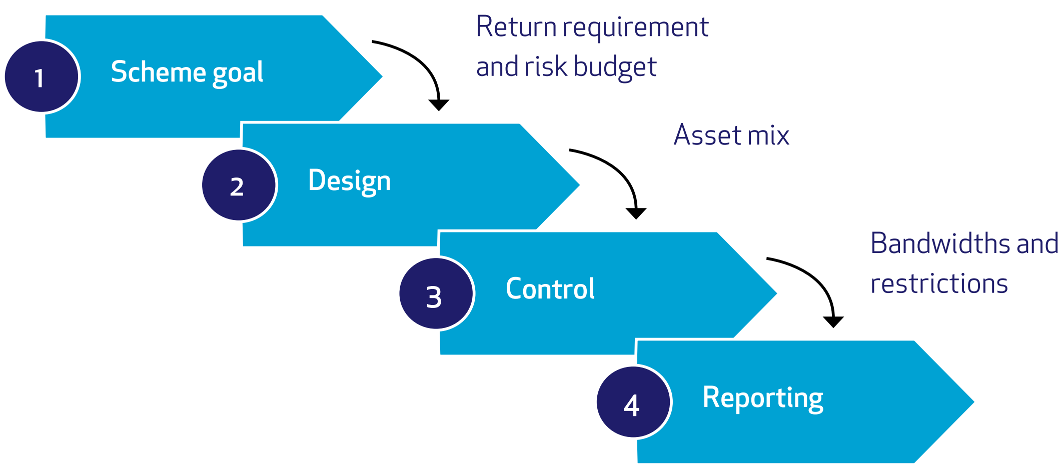
Some fiduciary managers may even offer the benefits from the experience of serving clients in multiple countries, where the experience of being active in one country can provide guidance for other countries where, for example, the market is in a different stage.

Fiduciary Management: The Next Generation

The concept of fiduciary management has evolved significantly over the past decade and will keep doing so in the future. I would like to share my vision on what I call the next generation of fiduciary management by elaborating on important themes and innovations. First, I will describe the innovative approach of the 'Decision Making Waterfall'. A second, related innovation is the 'Governance Framework'. The third topic is the changing value chain of the fiduciary management proposition: strategy is increasingly determined before giving execution mandates for the different asset classes. This results in an upward shift in the value chain.

The Decision Making Waterfall

The next generation fiduciary manager that I picture puts in place a process for managing the balance sheet for trustees. I will call this process the Decision Making Waterfall.[6] This is how it works. The decision making process of a scheme starts with setting the goal.



[6] This is based on an article by Hein Stam and Jeroen Trip from the Client Portfolio Management department of Mn Services that has appeared in 'Pensioen Bestuur & Management', 2011 (1).

This is what the scheme wants to achieve and what it needs to do so in the interplay of contributions, benefit enhancements (e.g. indexation uplift) and excess return requirement. The following step is the design: how is the scheme going to realise the excess return requirement in the current economic environment? Next is staying in control of the implementation. The final part is reporting, which is about the question: what information should be available to trustees?

Participants in the scheme demand clarity.

Balance sheet management is only possible when the scheme's funding objective has been decided upon and the impact and scope of the control mechanisms have been identified. Pension schemes can have different levels of balance sheet risk, for example when one scheme has indexation as a goal and the other one does not. In the last few years significant progress has been made in this area. In the past many trustees answered the question 'what will happen with the contributions when the funding ratio is much lower?' was answered with: 'that will be determined in the negotiations that will be held about this at that time'. Nowadays many pension schemes publish policy triggers that provide guidelines for what will happen with the contributions depending on the financial positions of the scheme. In the Netherlands, indexation policy is also increasingly determined as a function of the funding level. The investment policy, however, does not get sufficient attention in these policy triggers. That is remarkable. The contribution and indexation policy change depending on the financial position. Why then do the investment policy and risk profile stay constant? Participants in the scheme demand clarity. Pension schemes should have the ambition to go along with the general trend in society from 'trust me' towards 'show me'. When a pension scheme mentions full indexation as a goal, it should also indicate how it intends to finance that. What contributions and excess return requirement does this imply? Such transparency is necessary especially for maintaining solidarity as the interests of the different groups are not alike.

Setting the goal

In the first phase of the Decision Making Waterfall the goal of the portfolio is decided. In my view this is best done using the following three step process. First, the certainty equivalent is determined: what goal can be realised without taking any investment risks? Second, what excess return can be realised if we do take risk and decide to play the 'investment game'? The return in this second step must be higher than the return in the first step, otherwise the game will not be played and no investment risk should be taken. This is why it is called excess return. In step three the probability and impact of risk factors are analysed. There is interaction between steps two and three. The analysis of step three may lead to the conclusion that the distribution in step two needs adjustment. The advantage of this approach to setting the goal is there is no need for assumptions about, for example, equity returns. All risk factors can be translated into terms that can be used at the governance level: contributions, indexation and funding objective.

Designing the portfolio

In the second phase of the Decision Making Waterfall – the design of the portfolio – the trustees specify how the excess return requirement and the chosen risk budget are translated into an asset mix. Although this task can be delegated to the fiduciary manager, in most cases the fiduciary manager has an important advisory task in this regard. This is the phase where the investment plan shows up. The existing models used for an asset-liability management study are very valuable here. With these, trustees could investigate which asset mix achieves the desired excess return in the long term. Trustees could then decide to implement the long-term asset mix, without taking market conditions into account. This is one side of the design spectrum. The other side is that the pension scheme behaves likes a tactical short term investor. Given the risk budget, opportunities are constantly monitored and utilised in order to achieve the required excess return.

We advocate an approach where the pension scheme takes the long-term perspective in the design of the portfolio and then tests the portfolio against current market conditions and the valuation levels of the different asset classes on a continuous basis. This can lead to changes in the long-term asset mix. Looking at the long-term first avoid that the asset mix is decided upon based on tactical considerations only. This should be avoided because one should have a fair level of modesty about the predictability of financial markets. By separating the design phase in a long and a short term, it becomes clear which choices have been made. The term for this two step approach is dynamic asset allocation.

For example, a certain long-term equities allocation can be adjusted downwards if the current risks are considered to be too high. By using risk budgeting as a framework, such an adjustment can be supported systematically. A specification of the risk budget can give insight in the sensitivities and this way it can be determined where an upward or downward adjustment of risk is most effective.

The design phase includes a review of the feasibility of the excess return requirement, for example by an investment committee. From a governance point of view such a review contributes to the control of the scheme. If the feasibility of achieving the required excess return is not high enough, then it follows implicitly that the goal needs to be adjusted or that the goal needs a new design for implementation.

Staying in control

The design phase leads to an asset mix that should be implemented and executed. This translation from policy to practice is not self-evident. There has been proof of 'implementation shortfalls'. This is when the actual implementation does not entirely follow the design. The size of such shortfalls can be reduced by good mandates. This is part of staying in control of the implementation. An example is the interest rate hedge. If trustees set up a mandate where only a certain duration is set as a goal, the realisation of the interest rate hedge can differ substantially from what was expected. Matters such as non-parallel changes of the term structure, credit spreads and country risks can cause differences. A mandate should be designed in such a way that it will be realised within a certain expected range.

The size of implementation shortfalls can be reduced by good mandates.

Reporting

In the last phase, reporting, the trustees are informed about the developments in the investment portfolio. Traditionally the results of active management, alpha, have been dominant in reporting. The next generation fiduciary manager connects its reporting to the goal of the scheme and the mandates. The attention shifts from the investment portfolio to the development of the balance sheet and its risks.

It is important to note the sequential nature of the Decision Making Waterfall. For example, a change in the goal has consequences for the design, but not the other way around. However, it is possible that in one of the later phases it becomes clear that the goal needs to be adjusted.

Using the Decision Making Waterfall with the phases of goal, design, control and reporting is a good structured way for trustees and fiduciary manager to manage the balance sheet and prevent opportunistic decision making.

The Governance Framework

As we have seen, the fiduciary management model can be seen as a governance solution. It prevents delegating different tasks to different parties without anyone really being in charge of managing the overall goals of the scheme. The fiduciary manager does see managing the overall goals of the scheme as its main task and he does that by taking a holistic approach. Because governance is a strength of the fiduciary management model, it would be easy to think that the governance between the client and fiduciary manager is now arranged perfectly and needs no further attention. In my view, this is not the case. While the introduction of the fiduciary management model has indeed been a huge step forward in governance, there is room for improving the governance with the client even further.

There is room for improving the governance with the client even further.

What I believe would be a great move for the next generation fiduciary manager is to build what I call the Governance Framework. In the Governance Framework all the documents that are part of the governance between the pension scheme and the fiduciary manager find a place. Such documents include contracts, investment related policy documents, descriptions of procedures and reports. Some documents are provided by the scheme, some by the fiduciary manager and some are the result of an agreement between both parties. The documents are ordered in a logical hierarchy: they follow the structure of the Decision Making Waterfall described earlier. Each document belongs to one of the four phases of the Decision Making Waterfall. A document can also refer to other documents.

By making the whole governance visible, it also becomes clear if there are any 'blind spots' that need to be addressed. This can lead to dialogue between the pension scheme and the fiduciary manager on how and where the governance can be strengthened. For a fiduciary manager it becomes easier to locate blind spots and to proactively act on them when he has sharp insight in the governance relation he has with a number of pension schemes. This can also facilitate the development of best governance practices by the fiduciary manager.

The Governance Framework is based on some of the key principles of fiduciary management.

The idea of the Governance Framework is based on some of the key principles of fiduciary management. First, it improves transparency. This is because for every relevant topic there is a document readily available that provides the answer. Second, one clear overview of all governance related documents in a logical order truly shows the holistic nature of the fiduciary management model. Third, the guidance that the Governance Framework provides further enables the trustees to be in control: they can see how a certain aspect is organised in the blink of the eye.

Let me switch metaphors and go from waterfalls to dressers. A dresser with many drawers is what I like to compare the Governance Framework to conceptually: if the trustees want to see how a certain aspect of the governance between the scheme and the fiduciary manager is organised, they open that 'drawer' of the dresser and the answer (document) is there. Every topic is located in a drawer that has a logical place in the dresser.

The Governance Framework is also an answer to the increasing information needs of trustees. In many countries there is increasing pressure from supervisory authorities on trustees to be able to show them they are in control of the investments. With the Governance Framework this task becomes easier.

In my ideal world the Governance Framework would be realised in the form of a web portal.

In my ideal world the Governance Framework would be realised in the form of a web portal. This would result in all relevant documents that shape the governance between scheme and fiduciary manager being available to the trustees at all times in a structured framework, within a secure, user-friendly environment. A trustee can access the investment beliefs, the socially responsible investing policy, the investment plan for this year, risk management procedures, the latest reports and many other documents. He can do this at the office or even on the road on his tablet computer or mobile.

The Governance Framework would be an innovation that significantly strengthens the fiduciary management model.

The Changing Value Chain: Strategy before Mandates

The fiduciary manager has a broader mandate than the traditional asset manager. The traditional asset manager invests based on the mandate it receives. His approach is "give me a mandate and I will try to provide added value within the given restrictions". This means an asset manager is mainly interested in execution and not so much in determining the strategy of his product. The fiduciary manager has an unique opportunity to think about strategy before it gives execution mandates for the different asset classes.

The fiduciary manager has an unique opportunity to think about strategy.

Conversely, when you compare the fiduciary manager to the investment consultant that tries to help trustees select a product, the fiduciary manager distinguishes himself by his operational experience in implementing the strategy and mandate design. The investment consultant is traditionally strong in giving advice, but practice has shown that actually implementing a strategy is a whole new challenge that demands different skills.

In the old model of fiduciary management as it was originally developed in the Netherlands in the early years of the new century, probably only around 10% of time and resources would be dedicated to advising the pension scheme about strategy, 30% to the implementation of the strategy and 60% to execution. This emphasis on execution could be seen in a focus on outperformance relative to asset-only benchmarks.

The weight in the value chain is strongly shifting upwards.

In the new, next generation model of fiduciary management the weight in the value chain is strongly shifting upwards. Around 30% of time and resources is dedicated to advising the pension scheme about strategy, 60% to the implementation of the strategy and only 10% to execution. The focus is on advising the pension scheme and implementing the strategy.

Implementing the strategy can include asset allocation, designing the strategy of the asset classes, designing mandates and manager selection.

An example of the activity designing the strategy of an asset class is answering the question what countries are considered to be appropriate for in the fixed income portfolio. By thinking about the required criteria before the execution mandate is given, the criteria will be part of the mandate. This can prevent many types of risk, for example concentration risk, at an early stage and thus strengthen the portfolio. The policy with regard to socially responsible investing can also be considered as an integral part of the strategy. In this way it will automatically become part of the execution mandates for all asset classes.

With a well designed and well implemented strategy, the execution follows naturally.

Trustees demand much more from the fiduciary manager in terms of strategic advice.

This shift in the value chain is largely driven by the trustee challenges that I referred to before, such as declining funding ratios, increasing complexity and increasing regulation. Trustees demand much more from the fiduciary manager in terms of strategic advice with regard to all of these issues. Trustees also see the importance of good implementation of the strategy. Strategic advice to trustees may even include an opinion on the design of pension plans. In many countries discussions are taking place on what is the most suitable pension plan design. While it is certainly not the job of the fiduciary manager to be involved in negotiations between employers and employees on this, the fiduciary manager does not have to remain silent and can pro-actively advise trustees on the viability and practicality of suggested pension plan designs. A fiduciary manager that is true to the five key principles of fiduciary management definitely should do so.

In the introduction I claimed that, in the current pensions landscape, what the pension world needs is thought leadership and analytical power. I have argued that the fiduciary manager provides this and that he therefore plays an important role as a strategic partner for trustees in solving the challenges of the pension scheme. The evolution to the next generation of fiduciary management will only help in fulfilling this role.

Mathijs van Gool,
Stichting Pensioenfonds SCA

SCA decided to go down the fiduciary management route in 2008, just as many other Dutch pension funds have done in recent years. Before that, we had to cope directly with a number of asset managers ourselves and worked with a custodian who provided reporting to us.

Reaching a Higher Level

Whenever the board decided to change the investment policy, this usually meant that the assets had to be transferred from one or more asset managers to others. This often proved to be a slow process with high costs that required close coordination between the managers and the custodian. The board felt that it lacked freedom and flexibility in its decision-making. Also the parties we worked with provided little advice on our total portfolio, which meant that we had to formulate the investment policy largely on our own.

When we decided that the fiduciary management model would be a good way to address these problems, we started a careful selection process and considered a long list of potential providers.

In the end we chose Mn Services. There were three main reasons for this choice. First, we felt that their interests were aligned with ours because of their long history in pensions and the fact that they are still owned by pension funds. Second, they showed themselves to be a truly multi-client provider. Third, they were willing and able to offer the kind of flexibility that we required. With a fiduciary manager in place, we can now focus our attention on the most important strategic issues, relying on our fiduciary manager to implement our strategic choices. The fiduciary manager also pro-actively advises us and acts as our sparring partner with regard to our strategic choices. We also feel that the quality of the management information that we receive through reporting has improved.

With a fiduciary manager in place, we can now focus our attention on the most important strategic issues.

Because of its size, our fiduciary manager is able to provide us access to investment products that would be difficult, if not impossible, to access on our own. By this I mean not only certain asset classes and external managers, but also derivative overlays. We believe we should always be on the look-out for new investment opportunities and our fiduciary manager has helped us to broaden the scope of our investments. A further benefit of the economies of scale of our fiduciary manager is that they are well-positioned to provide information to us on important market developments as they are in contact with many other large strategic players in the market.

SCA feels comfortable about the fact that our fiduciary manager has a long history in pensions and has pensions as its only focus. This means they are able to understand our wishes, for example with regard to governance issues or socially responsible investing (SRI). Often this means they will pro-actively raise issues that we also believe are important to address. This level of understanding cannot necessarily be found everywhere.

Our fiduciary manager has been able to provide us the flexibility we were looking for.

Our fiduciary manager has been able to provide us the flexibility we were looking for. One example is the question of actively or passively investing in a certain asset class. Many asset managers have shown a preference for marketing active products as these are clearly more profitable for them. Our fiduciary manager has been very willing to discuss passive mandates, because this is an important topic for many pension funds.

Better pension fund governance requires more than appointing a fiduciary manager. The pension fund also has to make an effort to maximise its own expertise. This is precisely what has been done at SCA. We believe that in order for the fiduciary management model to be successful, the pension fund has to remain in control by ensuring that there is countervailing power. To that end, we have established an Investment Committee, which I chair as CEO of the pension fund and which also has three external experts. The Investment Committee functions as the bridge between Board of Trustees and the fiduciary manager. All investment proposals are discussed in the Investment Committee, which then advises the Board. But the Board has the final say. Having structured ourselves like this, we are able to interact constructively with the fiduciary manager.

Together we can reach a higher level.

The fiduciary manager can also benefit from the suggestions of its clients, many of which are becoming increasingly professional. These ideas can then be leveraged to other pension funds. Together we can reach a higher level.

Iain Brown,
Ernst & Young

In a fast moving financial world, a major challenge for UK pension schemes is to be able to make informed decisions, quickly and efficiently. Increased delegation can be of significant help to trustees that are resource constrained – be that of their own time and knowledge or in the resources available to them – together sometimes referred to as the scheme's 'governance budget'.

The View from a Selection and Monitoring Consultant

We often see a limited governance budget.

More and more, we find that the amount of time trustees are able to devote to investment related decisions is inconsistent with the level of investment sophistication that they are looking for in their schemes. If schemes are looking to implement a more sophisticated investment approach, but do not have the significant time and resources available to dedicate to such an approach, schemes can delegate more of the decisions by appointing a fiduciary manager. As a result, we often see a limited governance budget coupled with the need to implement a more proactive investment and risk management strategy being a key driver for schemes to explore their options.

The fiduciary management model clearly offers benefits through increased levels of delegation. But what do you delegate, how and to whom? In this respect, it should be noted that fiduciary management involves delegating both asset and liability management decisions rather than just asset management decisions. So it is quite different from selecting a fund manager, a process with which the trustees are likely to be familiar. This requires a greater level of understanding of pension scheme risk management by the client initially to make an informed decision.

There are a wide range of options and approaches adopted by firms that offer fiduciary management, with differing degrees of delegation.

Open and competitive tenders are a most effective way (and in my opinion, the best way) of enabling trustee boards to understand the various models and providers, and then make the selection most suitable for their needs, objectives and culture. Such a process enables the client to set off on the right path both in terms of the style of the solution and the cultural fit with the fiduciary manager. Wrong decisions can be made if it is passively assumed that all solutions are similar.

Preparation and openness with scheme information and objectives at the outset is key.

In order to have a successful tender, preparation and openness with scheme information and objectives at the outset is key. This does not mean simply supplying a pack of scheme documents. It involves seeking to articulate how the scheme's desire for investment return is balanced by its appetite for risk. This can involve some serious scratching of heads but inevitably will pay dividends throughout the selection process. In our experience, this approach is welcomed by fiduciary managers. The more specific information you can give the prospective fiduciary managers, the more helpful and bespoke responses you will normally get back.

Interestingly, once the selection process starts, clients can go through it in very different and unpredictable ways. We often find that clients change their focus as they develop more understanding of the solutions, the way that the solutions will be implemented and what this would mean for their schemes.

For example, some clients start out looking at full delegation but ultimately opt for a less delegated approach. Others, sceptical at the beginning, end up choosing a high level of delegation and some just let their approach evolve over time at a speed with which they are comfortable.

Essentially, there is no one-size-fits-all approach.

Clients and fiduciary managers will work very closely together.

Having trust and confidence in the fiduciary management is obviously crucial if a client is to make an appointment. Clients and fiduciary managers will work very closely together and ultimately clients will rely heavily on the fiduciary manager to help achieve the long term goals of the pension scheme. These human aspects are clearly important when working with asset managers but potentially become magnified when working with a fiduciary manager due to the increased level of delegation that can be taking place.

While fees are by no means the key selection driver, they are always an important issue for clients and the service should deliver value-for-money. A good fee structure not only acts to align the interests of the client with that of the manager, but also serves to incentivise the manager. The spectrum of fiduciary manager fees can be radically different. It is important for the client to understand the fee structure and the underlying cost drivers. We tend to sit between the client and the providers to ensure this happens. Under fiduciary management, a client's focus becomes less about achieving a target return and more about achieving a target 'risk level'. Fiduciary managers, as a result, have a much greater focus on risk and the schemes liabilities, making performance-fees which are linked to the funding level very important. Fee structures need careful examination so that the level of fee is consistent with the level of value added by the active, not passive, decisions taken by the fiduciary manager.

Despite the trust that must exist between manager and client, looking past the point of selection is also important. Clients are delegating more than ever to an external partner and, just like a fund manager, these firms should be monitored. Indeed, schemes are potentially delegating more of the decision-making regarding investment return and risk, so that a monitoring mechanism becomes very important indeed. This should not be restricted only to financial monitoring. We also look for the fiduciary manager to have a robust operational approach. This is key to reducing operational risk and covers everything from back office functions and support staff, through to IT systems.

An interesting development is the desire of finance directors to work alongside trustees to select a fiduciary manager.

An interesting development is the desire of finance directors to work alongside trustees to select a fiduciary manager. With many schemes now closed to new members and some also to future accruals, sponsors are also keen to establish a more effective governance framework which can introduce expertise into the decision-making process, increase the speed of implementation and enable a more sophisticated investment strategy to be developed. For many schemes, this alignment of interest between trustees and sponsor is becoming much more common.

So, my overall message would be for trustee boards and scheme sponsors to consider appointing a consultant, experienced in the space of fiduciary management, to provide guidance through the array of options, and then to monitor carefully the fiduciary manager's actions so that these actions remain consistent with the objectives and the approach agreed.

Robert Birmingham,
Xafinity

In the UK, defined benefit pension schemes face many difficult challenges, the most significant of which being how to manage their schemes deficit. Trustees need to put in place a deficit reduction plan that not only reduces the deficit, but also one that minimises risks and reduces funding volatility.

Considerations from a Trustee Advisor Perspective

Many schemes are now realising that a governance structure which incorporates a greater level of delegation may hold a solution.

Part of this plan needs to be an assessment of the schemes governance structure - asking how effectively the schemes assets are being managed, decisions are being made and how risks are being controlled. Many schemes are finding that the governance structure that they have in place is simply not effective. Due to a lack of resources, adequate time may not be spent on key decision making, there may be a shortfall in understanding of investment tools and asset classes, and decisions may be implemented too slowly to make the most of the opportunities identified. As a consequence, many schemes are now realising that a governance structure which incorporates a greater level of delegation may hold a solution.

Once the trustees have agreed on the deficit reduction plan, they are then faced with having to square their plan with the scheme's sponsor. Unfortunately in the majority of cases, the sponsor will not be able to repair the deficit at the rate the trustees would optimally want. While trustees' and sponsors' interests are aligned in the main, both wanting to reduce the deficit, when agreeing on a deficit reduction plan conflicts can emerge. Divergence between the views of trustees and sponsors primarily occurs in relation to the speed at which the deficit is repaired. This is because a swift deficit reduction plan will ultimately involve larger contributions from the company in the short term – an understandably undesirable option for the majority of businesses given the uncertain economic environment. Sponsors may then be willing to take a more optimistic view on future investment return potential.

This results in the company having to contribute less to cover the deficit at the cost of greater investment risk exposure - not something trustees tend to be too happy about. Despite these slightly conflicting interests, better run schemes possess more of a symbiotic relationship between the employer and the trustees. They both share an ultimate goal and both have the need of the other. Conflict between the two can only be prohibitive to meeting the schemes long term objectives and most schemes realise this and take steps to understand the others position.

Given these challenges, it is important to also understand that the solutions for the aforementioned major stake holders, sponsors and trustees, while having the same objective, tend to be slightly different. Trustees' emphasis is primarily on de-risking strategies, while deficit reduction exercises such as enhanced transfer values, pension increase swaps and early retirement exercises are very much top of sponsors' agenda. In order to implement the objectives of both trustees and sponsors, both these stakeholders are looking to implement a stronger governance structure and achieve greater alignment between the assets and the liability profile of the scheme.

Both trustees and stakeholders are looking to implement a stronger governance structure.

The solution is quite simply greater delegation. Improving pension scheme governance through greater delegation enables faster decision making and faster execution of these decisions on both the asset and liability side. Speed is at the heart of any progressive de-risking exercise because if you don't act in real time the market can move away from you very quickly. You could be provided with information and if you don't act within the next few minutes, never mind hours, you might find that the opportunity to act no longer exists. Traditionally trustees have not reacted quickly enough and in the fast moving and volatile markets of today, this is a bigger problem than ever. In the aftermath of the Myners report, schemes rushed to set up investment sub-committees allowing investment decisions to be taken by the sub-committee and not have to be referred back to a full body of trustees. The problem is that even with a sub-committee, trustees just don't have the time available to allow them to make investment decisions and execute them on a real time basis. To do this, schemes need to partner with a dedicated professional partner who has delegated authority to make investment decisions.

The fiduciary manager has the advantage of being able to leverage much greater scale.

Some of our clients have found this solution by partnering with a fiduciary manager. The fiduciary manager has the advantage of being able to leverage much greater scale than pension schemes alone could, and being 'in the market' which enables them to make and execute decisions in real time under a delegated mandate that would have the objectives and parameters clearly set out. I'm not sure whether it's an opportunity or a requirement for schemes to engage a fiduciary manager or some other professional partner in this way.

An area where we help our clients is ensuring they partner with the right provider, and select an appropriate solution. Fiduciary managers offer a diverse solution set, some of which are more suited to particular schemes than others. Size is a key driver here: while there is no hard and fast rules about the right size, the economies are not sufficient for a bespoke solution until you reach the hundred million pound mark. What we are now seeing however, is demand for vehicles that are more suited to the needs of the smaller pension schemes. The advantage of such solutions for smaller schemes is not only economies of scale and speed of implementation, but also the strength of information trustees would have access to. They would be able to see where their funding position is at any given point in time and quickly affect a shift in the asset allocation of their fund without huge cost or effort.

Trustees of large and small schemes alike will be under pressure in future to better align assets with liabilities and to secure extra investment return. These two objectives are not obviously consistent and can only be achieved through good governance, speedy execution of investment strategy and real time management of assets. Fiduciary management of one sort or another will be crucial in this.

Andrew Waring,
Merchant Navy Officers Pension Fund

Sponsors are increasingly viewing pension schemes as a business in their own right, and they are not wrong to do so. Problems arise when pension schemes, and the risks associated with them, become so financially significant they impact the sponsor's primary business. If they're not managed properly, pension schemes can become a significant burden for the Sponsor.

A Maritime Success Story

The MNOPF has continued to innovate in order to meet the challenges of managing a pension scheme. The scheme was closed to new members in the 1990's, and with the emergence of the first deficit in the 2003 actuarial valuation, and then a further deficit in 2006, the Trustees and Employers were quite rightly keen for a long term strategy to be put in place. This lead to the decision to hire a chief executive in 2007, and I was appointed in 2008.

One of the first areas requiring attention was the Old Section of the scheme (pre '78 benefits) which was near fully funded and very mature. There were opportunities to take risk off the table and improve the security of member benefits, whilst also reducing the risk to the employers of future deficits emerging. The second area to be reviewed was the scheme's investment governance structure and decision making process. Since 1990 the fund had progressively been outsourcing its asset management. By 2008, all that remained internally in the MNOPF Executive was residual investment operations and investment administration activity. It was quite clear from the start that these remaining internal operations confused the investment decision making process. Some of our investment consultant's proposals would have to run through the investment sub-committee, whilst others would be run through the in-house team. This led not only to confusion, but also a lack of responsibility and accountability. It was difficult to pin down who was responsible for the investment performance; the investment consultant, the in-house investment team, the investment sub-committee or the trustee board? Eventually, given the significance of the financial decisions that were being made, in October 2008 we created a role we called a Delegated Chief Investment Officer (CIO), more broadly known as fiduciary management. The Delegated CIO was given responsibility for implementing the fund's investment strategy, and had a direct reporting relationship through to the investment sub-committee.

It was difficult to pin down who was responsible for the investment performance.

Greater responsibility and accountability was not the only driver for employing a Delegated CIO. The investment world is forever increasing in complexity, with ideas, instruments, strategies, and asset classes evolving very quickly. At the MNOPF, and I'm sure many UK schemes have the same problem, there is a limited 'governance' budget available. Trustees have a limited amount of time available, meetings are generally quarterly and decisions are not real-time. It is not always acceptable in today's fast moving investment markets to have to wait for the quarterly cycle of committee meetings or to coordinate diaries for conference calls. Many investment sub-committee meetings are spent listening to manager presentations, which always have a positive beat because managers struggle with imparting disappointing news. Investment sub-committees often spend a lot of time on relatively small, financially insignificant investment management decisions and very little time on the very significant strategic investment matters. The MNOPF investment committee understood that it had limited time capacity and capability when selecting investment managers. Selecting managers is the sexy part of the Trustee role, but in truth adds very little value when compared to strategic asset allocations decisions. By delegating more of the investment strategy implementation we were able to free up time to spend on the big strategic risk management and asset liability matters.

By delegating more of the investment strategy implementation we were able to free up time.

In practice, the Delegated CIO operates within our strategic investment parameters; the Trustees decides the investment strategy, overall return and risk parameters, what asset classes the Delegated CIO can invest in and the allocation range for each investment class. It is important that the Delegated CIO stays within these strategic parameters, and we monitor this and evaluate progress towards our long term strategic goals. The structure we adopted involves a high level of delegation to our fiduciary manager. We think this allows a far greater level of clarity and responsibility, and therefore greater accountability. But it's important to understand that we're not actually delegating responsibility, the Trustees are obviously still ultimately responsible, we are only delegating the day to day implementation of the strategy within predefined parameters. That said we realised that this is arguably the most financially significant role in the management of the fund, which is why we wanted to introduce another pair of eyes as a check and balance on the advice and activities of the Delegated CIO. We have therefore enhanced our process with the appointment of an independent investment adviser. This role is not designed to argue everything the Delegated CIO is doing, but to reassure the Trustees of their proposals and their capability to execute them going forward. Both the MNOPF and our Delegated CIO see this as absolutely critical for our model.

Appointing a Fiduciary Manager was for us about investment governance, effective decision making and ultimately improving investment performance.

Ultimately, appointing a Fiduciary Manager was for us about investment governance, effective decision making and ultimately improving investment performance. It has allowed us to make the most efficient use of our 'governance budget' and has made sure the investment committee spends its time focusing on the strategic matters that add the most value to the scheme. We have delegated the very complex investment decisions to professionals who have got the depth and breadth of resources and expertise across all the asset classes to make the best decisions possible.

The MNOPF is certainly at the forefront of the 'end game' in DB pensions. We are probably further down the path of liability settlement and have more clarity around our settlement objectives than many other schemes. We understand that in the mature DB marketplace it is crucial to have integrated actuarial, investment and insurance thinking. By redesigning our investment governance structure and employing a fiduciary manager to work alongside an investment sub-committee and an independent investment adviser, we believe the MNOPF have set a new standard in pension scheme governance. We genuinely have got world class organisations advising us, looking after the assets, and taking real-time investment decisions. The benefits do come through, there is far more time spent on strategic investment matters, far quicker decision making and swifter implementation. Most importantly we're seeing significant improvements in investment performance and a lot of operational friction has gone out of our process. I hope my trustee directors sleep more comfortably at night, I do!

We're seeing significant improvements in investment performance.

Tony Fisher,
Capgemini Trustees

The Capgemini pension scheme was historically based on a 'traditional' investment strategy, with high exposure to equities and some gilts. This was a very common investment strategy for many pension schemes at the time. Because of our exposure to equities, the scheme suffered during a number of the equity market downturns we have experienced over the years.

Fiduciary Management in Practice, a Client's Perspective

Capgemini is one of the world's foremost providers of consulting, technology and outsourcing services. The Trustees of Capgemini's more than £900 million Defined Benefit pension scheme, acting on behalf of their more than 9,000 members, hired Mn Services as their fiduciary manager in 2010.

These market downturns seemed to be occurring more frequently and we realised that we could no longer run the risk of riding out the market volatility we were exposed to. This situation prompted us to re-evaluate our investment strategy and look for something that would give us more certainty in our investment return and reduce the risk we were exposed to. We engaged with Xafinity, our pension advisors, and together we decided to implement a more diversified investment strategy. This involved investing in a number of new asset classes and through a larger number of managers, with an end view to spread/reduce our investment risk and build a more balanced portfolio.

Having formulated our strategy to build a more diversified investment portfolio, we were then faced with quite a steep learning curve to familiarise and educate ourselves on all the new instruments we were considering investing in, which was a painful but necessary process. Once we felt we had a proper understanding of these new products, we started the selection process. Xafinity organised a large number of managers that might meet our needs and after a lengthy process some ten funds were mandated to provide the various elements of our strategy.

Once this strategy had been implemented, we realised that despite our understanding of the asset classes and instruments we were investing in, our ability to actively manage these ourselves was very restricted – we were not investment professionals after all. The increased number of new and more complex instruments we were using required much more time and resources to keep track of, monitor and manage in the way we felt was necessary to fulfil our governance responsibility. Having done the right thing, we just felt that we were not in full control.

We saw the value in having a professional oversee the investment implementation.

We found a solution to this, again with the help of Xafinity, by partnering with a fiduciary manager. This was a relatively new solution in the UK at the time but we saw the value in having a professional oversee the investment implementation, manage new contributions to the scheme and keep our portfolio in balance with our liabilities. Obviously the responsibility for the scheme's funding still remained with the trustee board, but by delegating the day to day investment process to a professional, we felt we were in a much stronger position to focus on the schemes strategy and governance.

The process in selecting a fiduciary manager was similar, although more rigorous, than what we had done previously for our investment managers. Xafinity helped us build a short list of providers who looked equipped to service us and then we held face to face meetings, did our due diligence and also focused on their track record as a fiduciary manager – taking references from existing clients.

As a result of this process we selected Mn Services with the belief that they were best positioned to meet our needs. Mn's pedigree was an important attribute to us, originally as a pension scheme themselves, then evolving into a focused fiduciary manager dedicated to the pensions space. We were also impressed with Mn Services' proposal for managing conflicts of interests. Importantly we felt that Mn Services would be acting in our best interests at all times. We believe it is very important that a fiduciary manager can provide independent strategic advice and is not conflicted when allocating assets to managers within our strategy.

Although it is relatively early days, by partnering with Mn Services as our fiduciary manager we have been able to improve the governance of the scheme, allowing us to manage a more diversified and sophisticated investment strategy which has controlled risks and will hopefully enable us to meet our long term funding targets. Personally I am very pleased.

Petra Zamagna,
Ambitus GmbH Asset Consult

A tale from a non-mainstream consultant operating in Germany

The term and model 'fiduciary management' were first created and implemented in the Netherlands around 2000. Over the years it has become quite a successful solution model put into practice by a fair number of corporate and public pension schemes.

Fiduciary Management in Germany

It also went through a development from 'outsourcing too much' to 'keeping in the driver's seat'. Paul Boerboom from Avida International, who has been at the forefront in developing various types of fiduciary and advisory models , says: "Fiduciary management is not the holy grail, but if well structured it might be far better than the traditional implemented consulting model which is still applied in many countries. Pension trustees are exposed to a high amount of uncertainty and volatility with funding ratios often below the required levels. This environment yields a new more professional way of managing pension funds. Bottom line: high performing pension funds have strong and competent trustees who are in control. They have strong internal organisations of competent people. They might delegate some activities to an external firm, provided that the interests are well aligned. In the Netherlands these lessons have generally been taken on board: a new generation of fiduciary deals has emerged with a more balanced approach. The first movers in fiduciary management have by now re-evaluated their investment organisations and relationships with the investment consultants and fiduciary managers."

A new generation of fiduciary deals has emerged with a more balanced approach.

In Germany we still see that a lot of consultants oppose the concept. And the word 'fiduciary management' is not even used by the corporations implementing it. The reason for this 'absence' and 'opposition' seems to be that German-based consultants quite often like to offer some risk-budgeting approach themselves and therefore do not want to propose rival providers in this respect. Looking at the historical roots of financial pension management in Germany might clarify things.

The German pension world has long been dominated by house-bank solutions.

The German pension world has long been dominated by house-bank solutions (in the 80s and 90s) with opaque fee structures and little willingness by either the corporates/public pension vehicles to change this nor by the banks to lose a satisfying relationship which often displayed very low upfront-fees but contained quite a number of non-visible kickback agreements and practices.

A change was first introduced by moving the corporate responsibility for pension asset management from HR to Treasury. This led for example to the introduction of the first global custodians – a situation initially fiercely opposed by the German banks and their custodian business. In the end they did not, however, block this development. Then a second change came into fruition by making internationally experienced treasury managers (i.e. at BASF Dr. Böhm, at Siemens Peter Scherkamp, etc.) responsible for pension asset management. The use of consultants was one of many steps in this process. Fee structures and asset management capabilities were questioned and the German asset management market was modernised.

The situation has also resulted in a fertile field for consultants to develop. And in fact, consultants like RCM and Alpha Portfolio were growing from zero very rapidly in the 90s and 2000s. And international consultants like Towers Watson, Mercer and Hewitt found good reasons to expand into Germany. Even Swiss consultants like Complementa and PPC Metrics used the German speaking common ground to make inroads into Germany. Sometimes cooperations with local consultants were forged – but did not always prove successful.

We are approaching the third change management phase with the emergence of fiduciary management solutions.

Now it seems we are approaching the third change management phase with the emergence of fiduciary management solutions. Even if the phrase 'fiduciary management' is not really at the forefront, we see companies (like Robert Bosch GmbH and Henkel) that implement it in some form. We could also see with the emergence of new pension vehicle solutions (Contractual trust agreement structure since 2000 and 'Pensionsfonds' since 2002) that the professionalism in managing the pension money for employees, deferred personnel and pensioners has further increased in Germany.

There is a wish to manage pension money in a more predictable and less crisis-prone way.

Additionally there has been a lot of pressure from governing bodies or management (Executive and Supervisory Boards) as well as rating agencies during the capital market turmoils in 2000-2003, 2007-2008 and 2011. Furthermore, accounting rule changes are leaving an impact. This trend toward more professionalism in managing assets and in representing the trustee world will, if anything, deepen. All this market and regulatory pressure is leading among others to the wish to manage pension money in a more predictable and less crisis-prone way.

Unless they are very cash rich, treasury departments in the corporate world usually do not have a lot of asset management expertise. Therefore, a fiduciary management solution is very attractive. Depending on the in-house capabilities, one can outsource a certain amount of risk and asset management, meanwhile engaging in building up the internal team to take over some of the outsourced issues at a later moment. Or one can start from a big in-house team and outsource only the parts which would be too costly to cover in-house. At the same time, the use of a number of swap structures allows a more active participation of the treasury inherent capabilities of corporates.

So, to sum it up, the trend will also in Germany lead to the implementation of more 'fiduciary' like models. Additionally we are at the beginning of a new trend, where corporations start to use the possibilities being prepared by European legislation regarding the 'European Pension Fund' to replace the country-by-country approach applied so far. This will again lead to a bundling of expertise in one only vehicle – so far mostly based in Belgium, Ireland, Luxembourg or Netherlands – and therefore the professionalism and the newest, most convincing models of managing pension assets will further penetrate the market. So far mostly only Swiss, British and Dutch companies explore the territory of 'European Pension Funds', but German ones are to follow.

Nigel Birch,
Spence Johnson

Fiduciary Management has grown to become a prominent part of the institutional asset management and consulting business in Europe. Growing Fiduciary Management teams are engaged in servicing large and mid-sized pension funds across the Netherlands, UK, Germany and elsewhere. Journalists are frantically typing up ever longer special features on this topic, and by law all asset management conferences now have to mention it on their programmes. And yet... there is still confusion surrounding the market and its growth. This article attempts to dispel some of that confusion.

The Growth of Fiduciary Management in Europe

The Fiduciary Management market in Europe is provided by about 30 firms (although only a small percentage of these have what you would describe as a serious Fiduciary Management focus). Between them they manage €761bn in assets on behalf of 517 clients. Most of the 517 client organisations are Defined Benefits Pensions plans, but a few are other types of Institutional investor – predominantly insurance funds. On average each client has assets under Fiduciary Management of €1.5bn, but this figure is influenced heavily by a few very large users and the average varies widely from country to country.

The 30 providers that we have identified fall into three categories:

Pensions Heritage firms

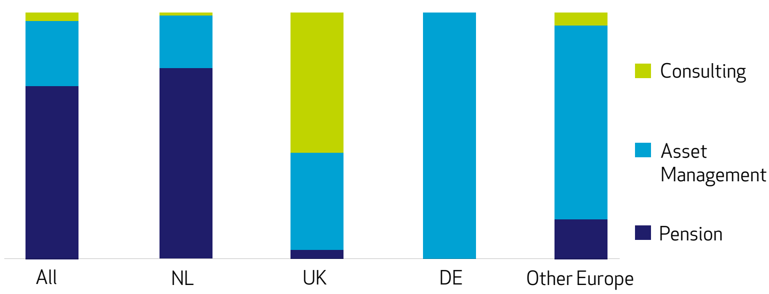
The largest market share is held by a small number of what we call 'Pensions Heritage' firms whose first steps in Fiduciary came from managing their own In House pension fund, and who have since offered this service to third party pensions clients. Leading examples include Mn Services and PGGM. Between them this small group of Pensions Heritage firms manage €7 in every €10 of Fiduciary assets. But this includes their sizeable seed pension funds which on their own make up around half of the market.

Asset Management Heritage firms

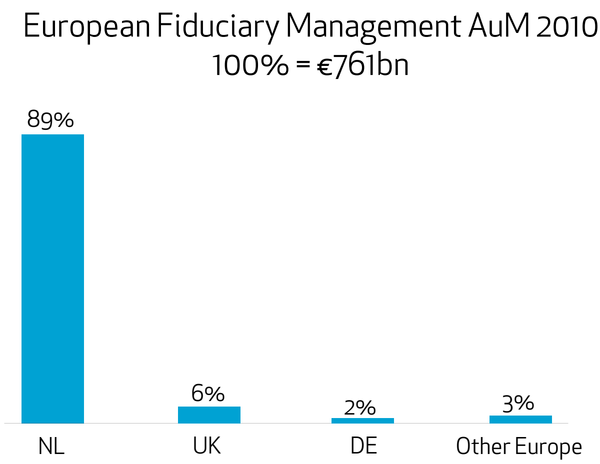
The majority of providers come from an Asset Management Heritage. They offer the range of Fiduciary services as a natural extension of their investment activities. Between them the asset managers manage most of the external client assets and a sizable chunk of the overall assets as can be seen on the chart below.

Consulting Heritage firms

The third group, from a consulting heritage, have evolved to provide fiduciary Services from their existing advisory roles with pension plans. This group has tended to focus on smaller clients, so while they have a significant proportion of the number of clients, they retain only a small proportion of the overall assets in the market, although a significant amount of the UK market.



The €761bn in Fiduciary Managed assets is predominantly located in the Netherlands. Other countries are starting to grow however. 89% of the assets are in the Netherlands, with just a 6% share for the UK and 2% for Germany. Other countries in Europe, particularly Italy and France, represent the remaining 3%. Even after excluding the large seek clients of the pension heritage firms that make up so much of the Netherlands Fiduciary market, the Netherlands still represents 78% of the assets. The Netherlands was where the first Fiduciary appointments took place and where the market started its growth. Arguably that market is now beyond growth - Fiduciary assets in the Netherlands are the equivalent of 82% of the country's total DB pension assets.

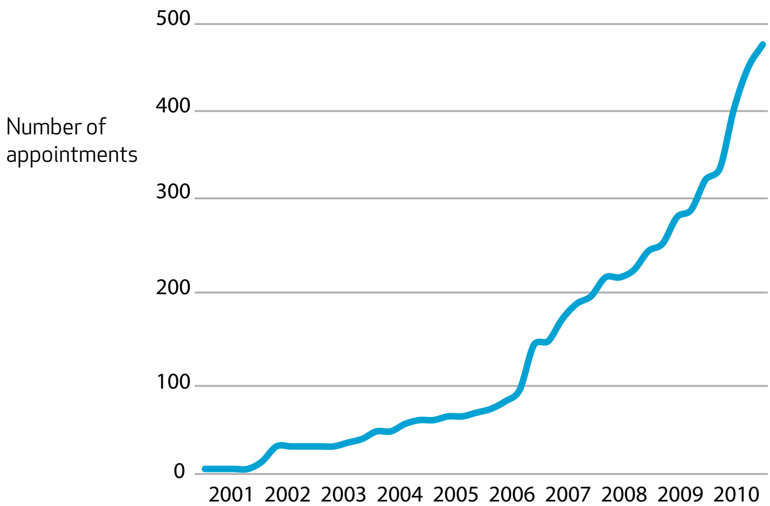


There is clearly huge growth potential in markets outside the Netherlands.

There is clearly huge growth potential in markets outside the Netherlands. For example, in the UK Fiduciary managed assets amount to only 4% of DB pensions. Providers from the Netherlands, the UK, France and Germany are being quick to exploit this potential. We have counted 20 firms that are active in supplying the Netherlands market. But there are already 15 firms who have UK clients.

Growth in Fiduciary Management has been particularly noticeable in the past two years. In 2009 we predicted that the financial crisis would give Fiduciary Management "a great opportunity" arguing that schemes will look to form deeper partnerships with providers who are able to supply solutions rather than push products. Since the crisis schemes have tended to focus on 'outcome strategies' rather than 'possibilities' and focused more on specific funding targets for the scheme. The chart below shows the growth in the number of Fiduciary Management appointments since 2000 among a sample of 114 firms across Europe all of whom now use a Fiduciary service. What it clearly shows is the two surges in the uptake of firstly in 2007 following the introduction of the FTK in the Netherlands, and secondly following the end of the worst of the financial crisis in 2009. The second surge has been particularly dramatic and has also been contributed to by Fiduciary Management growing in new European markets.

Fiduciary Management appointments by date



In summary, we have seen significant growth of the Fiduciary Management model over what is a relatively small timeframe for a notoriously slow moving market such as pensions. We believe that this is a very telling sign that Pensions are realising that they can no long afford to be slow moving and responsive. The economic uncertainty and volatility are demanding schemes to be proactive in their decision making, and this is why Fiduciary Management offers such a compelling solution. For this reason we believe the European trend towards Fiduciary Management will continue to gain momentum.

About Mn Services

With more than 60 years of experience, Mn Services is one of the leading fiduciary managers and pension administrators in Europe. As fiduciary manager, Mn Services manages assets in excess of €72 billion for Dutch and UK pension schemes. As pension administrator, Mn Services administers the pensions for several Dutch pension schemes, representing some 1.9 million members and 36,000 employers.

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