



Fiduciary Manager Investment Performance Study 2020

In this first of its kind review of fiduciary manager investment performance for UK pension funds, we assess how managers have performed across mandates with comparable risk-return objectives up to 31 December 2020.

Thanks to newly-launched requirements and standardised methodology for fiduciary managers, we are now able to assess performance across total pension fund assets relative to changes in liabilities. That means, for the first time ever, we can build a reliable picture of how fiduciary managers have impacted pension funding positions.

And what a year 2020 was to mark our inaugural FM performance review. The global Covid-19 pandemic has been tragic and disruptive, with considerable volatility returning to financial markets after a prolonged period of relatively benign conditions supportive of market growth. Despite market turbulence, many markets ended the year on a high, with double digit returns from global equity markets, falling government bond yields and credit spreads tightening.



How then have fiduciary managers performed and what trends have we witnessed?

1

A continued trend of pension fund de-risking, with increasing proportions of FM mandates having lower investment return objectives and higher liability hedging requirements.

2

A weaker relationship between risk and return over the 12 months. In other words, in contrast to recent years, it is less clear that fiduciary managers were rewarded for taking risk in 2020.

3

Over 2020, investment performance has been mixed and somewhat dependent on the level of return being targeted. For Low and Medium Return targeting mandates, most fiduciary managers achieved their investment return objectives; for High Return targets, fewer managers were successful.

4

Wide variation in investment returns and ability to protect against short-term market falls. This applies mainly to medium and high return targeting mandates and can be explained by a wide variation in investment approaches and liability hedging strategies, even among pension funds with seemingly high levels of hedging.

5

Clear evidence of fiduciary managers adding value for pension funds targeting a moderate level of returns over the long term. For mandates targeting higher returns, success continues to be mixed; for mandates targeting lower returns, closer consideration of value for money is needed.

6

Differences in returns within fiduciary managers' own portfolios indicates differing levels of customisation in portfolios to reflect specific pension fund needs.

Our conclusion is that a pension fund's choice of fiduciary manager continues to have a significant financial impact, emphasising the importance of this decision for trustee boards.

The variation in performance highlights the importance of pension funds understanding what is driving their investment returns and the impact of their managers' decisions. Barnett Waddingham's study of multi-asset investment performance last year looks at this in more detail.

In terms of liability hedging, with most pension funds now having in place high levels of hedging, we expect more scrutiny to be placed on the accuracy of hedging approaches in future.

We have also highlighted some important issues to be aware of in using and interpreting performance information calculated in line with the GIPS® for Fiduciary Management Providers ("FMPs"). While we believe this information is useful for high-level industry performance observations, care should be taken in interpreting the results at an individual pension fund level.

FM mandates – investment risk-return objectives

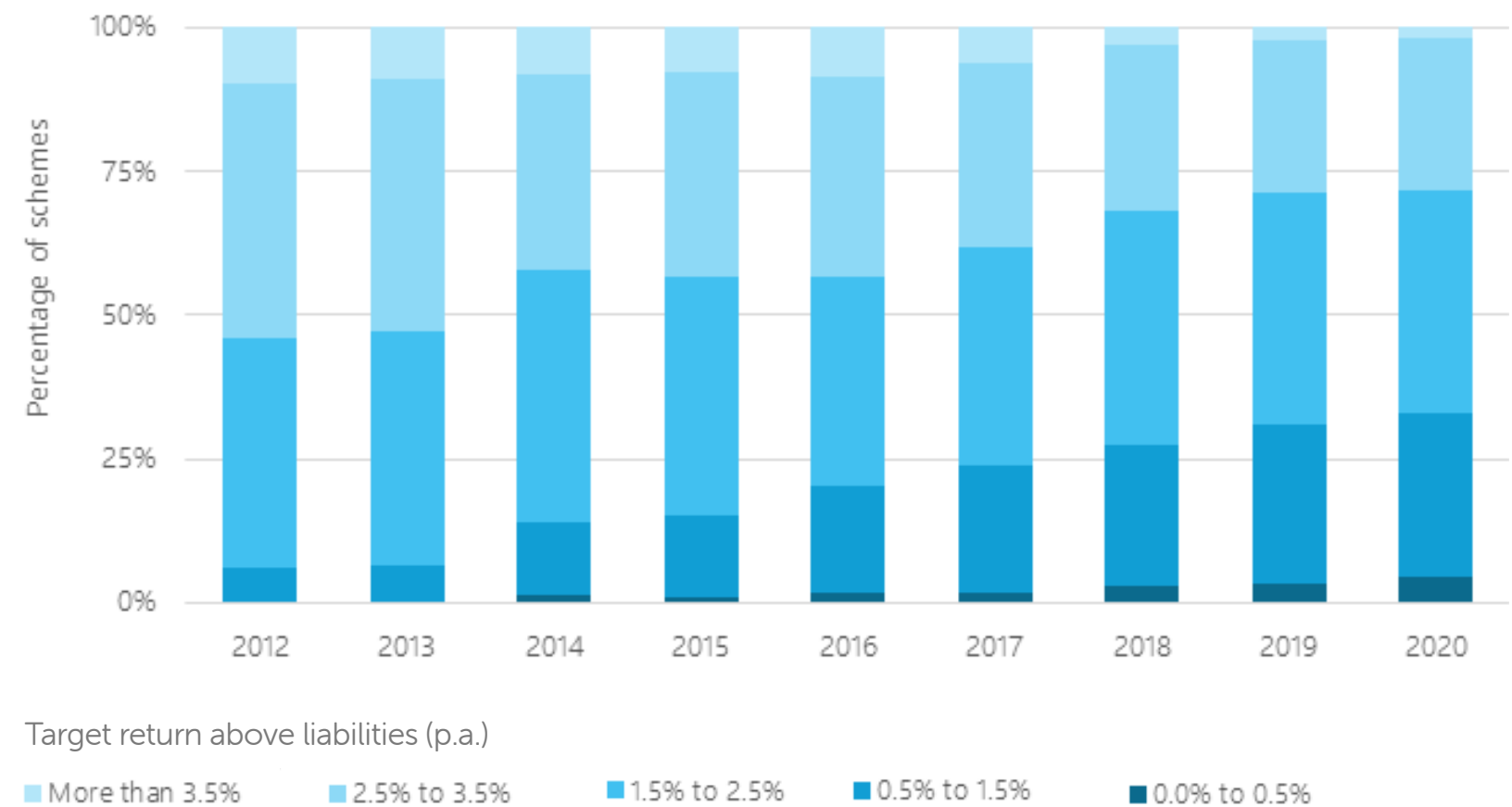
We start with some context about the range of investment mandates given to fiduciary managers by UK pension funds. A key feature of the GIPS® for FMPs methodology is that it categorises pension fund mandates according to the investment objectives and liability hedging guidelines². This enables us to build up a picture of the profile of investment mandates in place.

An explanation of the different FM investment mandate categories can be found at the end of this paper. In summary, the categories vary by:

- target investment return relative to a pension fund's liabilities (i.e. Liabilities + x% p.a.);
- any guidelines on the level of liability hedging; and
- any other material asset restrictions.

FIGURE 1: SPLIT OF FM MANDATES BY TARGET INVESTMENT RETURNS

457 SCHEMES IN 2020³



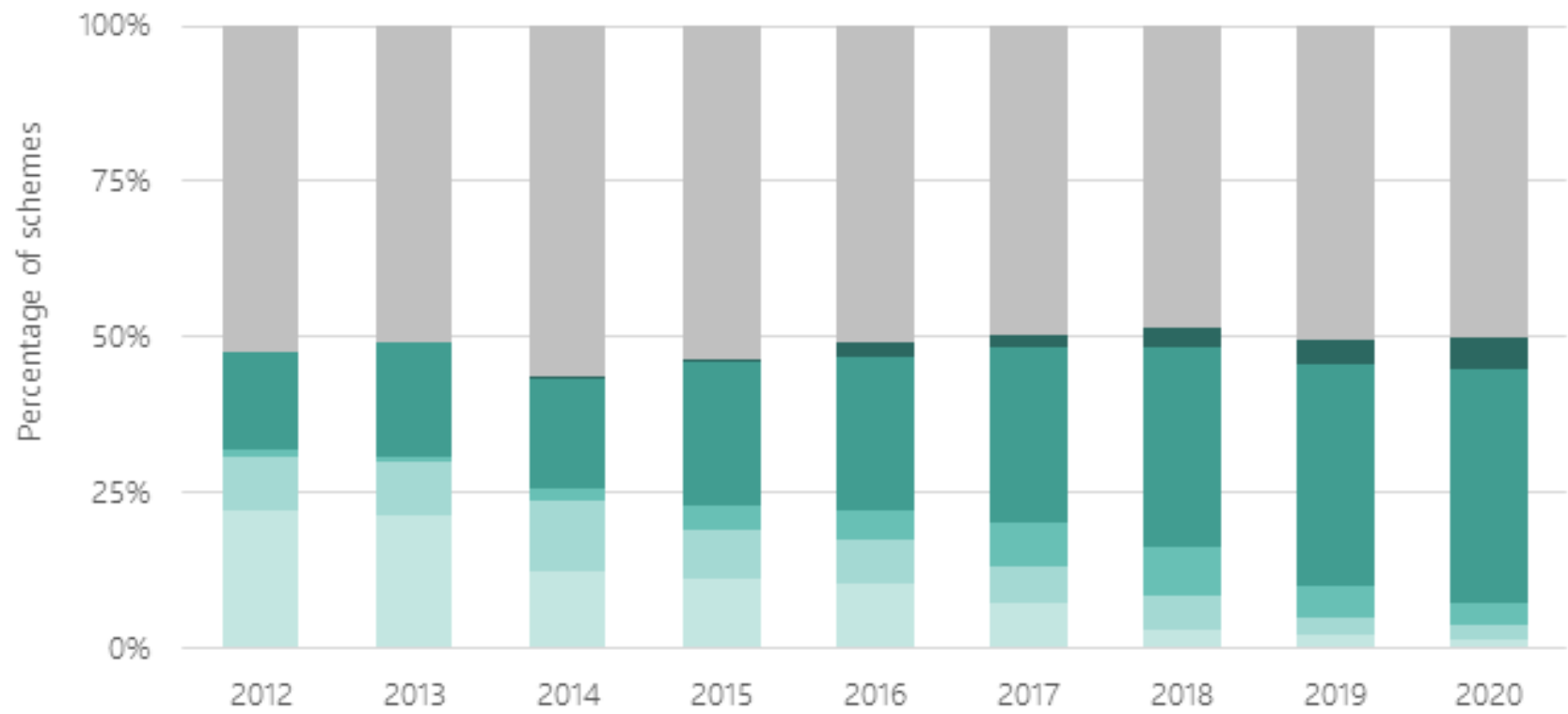
We can see the evolving return objectives of FM mandates reflect the broader de-risking trend we are seeing across UK defined benefit pension funds. Although around two-thirds of FM mandates are targeting a return of above 1.5% p.a. in excess of liabilities, this has dropped notably over recent years, with an increasing number of mandates targeting lower returns.

² All data presented in this report is based on a 'full liabilities' basis as defined under GIPS® for FMPs methodology (as opposed to the 'hedge-adjusted' basis).

³ All pension scheme numbers quoted in this paper represent numbers present in the data at the end of the relevant period of observation.

FIGURE 2: SPLIT OF FM MANDATES BY LIABILITY HEDGING GUIDELINES

457 SCHEMES IN 2020



Guidelines on target level of hedging (of funded liabilities)

- Unconstrained
- 100% +
- 80% to 100%
- 60% to 80%
- 40% to 60%
- 0% to 40%

It has been the case for some time that around half of FM mandates give the manager significant discretion on liability hedging levels (the unconstrained category). Despite this discretion, in our experience the vast majority of unconstrained hedging mandates hedge in excess of 80% interest rate risk where affordable.

The other half of mandates have tighter hedging guidelines in place. It can be seen that the nature of these guidelines has changed – by the end of 2020 the vast majority of FM mandates had in place high levels of liability hedging (80%+ of funded liabilities).

We make the following observations:

- It is clear very few managers are taking material risks in relation to interest rates and inflation.
- With high levels of liability hedging in place across the industry, we expect more scrutiny to be placed on the accuracy of a fiduciary manager's hedging strategy in the future as it becomes a higher proportion of a scheme's risk budget.
- Even within this higher category of liability hedging, small differences can have a significant impact on returns. For example, all else being equal, a pension fund with 80% hedging may have experienced 2-4% lower returns (relative to liabilities) over 2020 than a pension fund with 100% hedging.

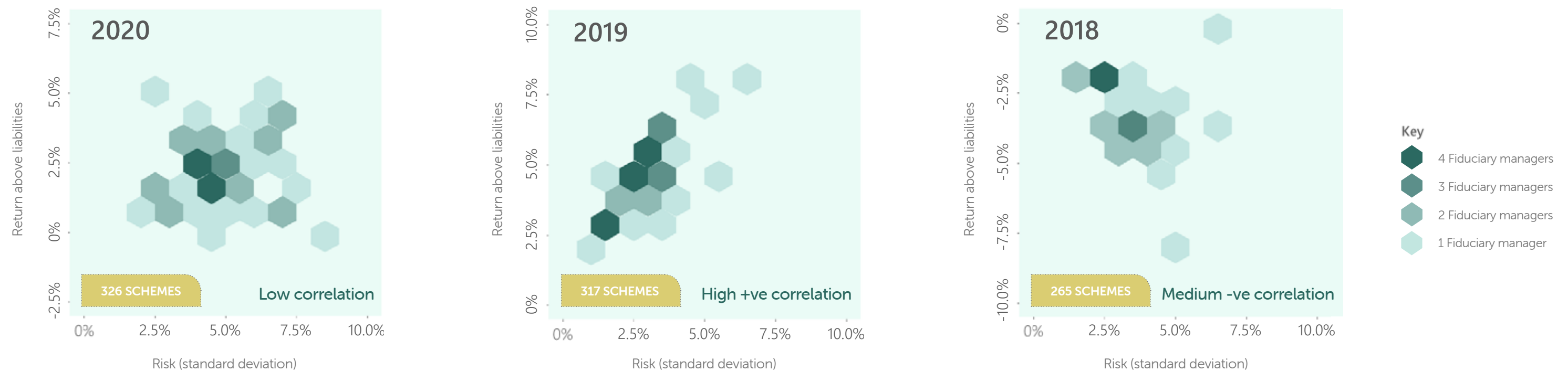
FM investment performance

We now turn our attention to investment performance and risk management across different mandate categories. We have chosen to focus our analysis on the three most popular investment return categories – labelled as high, medium and low return – and combined categories with a high level of liability hedging⁴. These categories account for around 75% of the mandates covered by this review.

It is important to be aware of the limitations in the performance and categorisation methodology, not least the wide range of return targets within these mandate groups. We reflect on this further later in this paper.

⁴ Low Return; High Hedging: Investment return: Liabilities + 0.5% < x ≤ 1.5%; Liability Hedging: 80-100%, Unconstrained
Medium Return; High Hedging: Investment return: Liabilities + 1.5% < x ≤ 2.5%; Liability Hedging: 80-100%, Unconstrained
High Return; High Hedging: Investment return: Liabilities + 2.5% < x ≤ 3.5%; Liability Hedging: 80-100%, Unconstrained

FIGURES 3 (A, B AND C): RISK-RETURN RELATIONSHIP ACROSS 75% OF FM MANDATES



The charts plot the average return and risk each fiduciary manager achieved for their clients across the high, medium and low return mandate categories referred to previously. It is clear the risk-return relationship was much weaker in 2020 than the previous two years. 2019 saw equity markets follow an upward trend, reversing the downward trend over 2018. Market volatility in both years was low in comparison to 2020. This tells us that risk taking by fiduciary managers was not always well-rewarded last year. Market volatility provided opportunities to make sizeable returns, but if these were missed or portfolio changes were poorly timed, it will have had a detrimental impact on returns. The clearest example of this was in relation to liability hedging decisions. Even within the highly-hedged mandates shown, the sizeable fall in gilt yields meant that seemingly small under-hedged positions led to meaningful volatility in funding levels and with it a negative impact on returns.

FIGURE 4 – FM OUTPERFORMANCE ABOVE LIABILITIES IN THE 12 MONTHS TO 31 DEC 2020



FIGURE 5 – FM DOWNSIDE PROTECTION IN THE 12 MONTHS TO 31 DEC 2020



Figure 4 shows the 2020 calendar year returns across the three mandate groups described previously. Each fiduciary manager has provided us with the average level of outperformance (over liabilities) they achieved for each mandate group. The bars represent the range of average outperformance from the managers, showing the four quartiles and the median.

Figure 5 shows the range of maximum 'drawdown' on average for each manager across the mandate groups. Broadly speaking, this can be thought of as the largest funding level falls experienced during 2020, on average with each manager. We make observations on each mandate group in turn.

Click (+) in the [online interactive version](#) of the study on our website to read our observations on each mandate group.

Low, Medium, High return target

FIGURE 6 – FM OUTPERFORMANCE ABOVE LIABILITIES IN THE 5 YEARS TO 31 DEC 2020

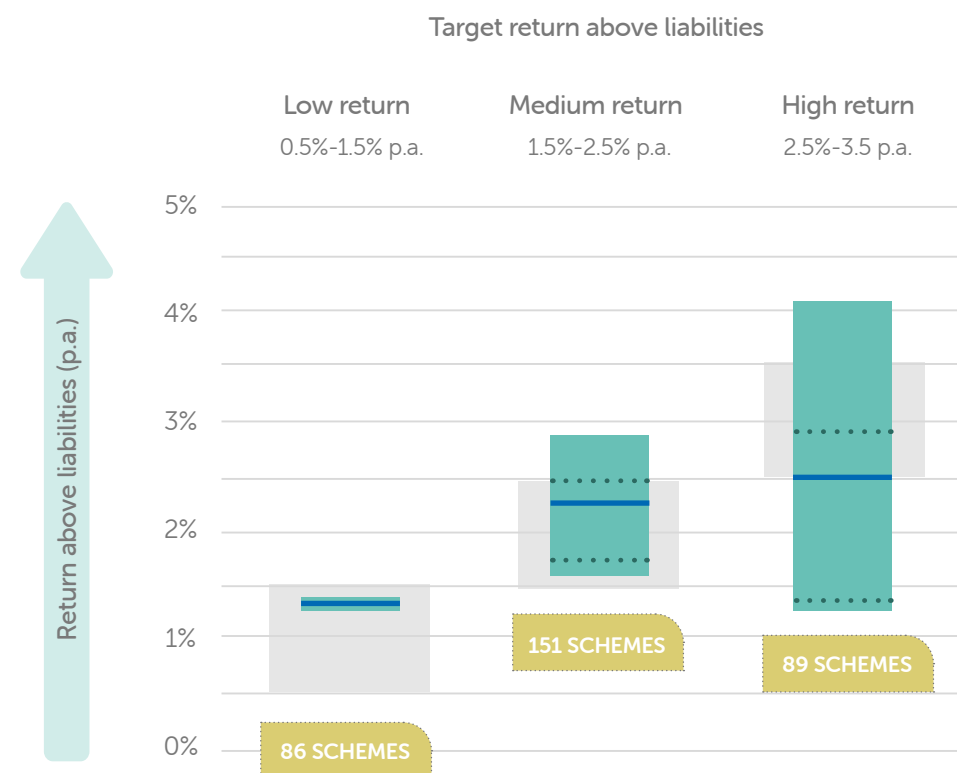
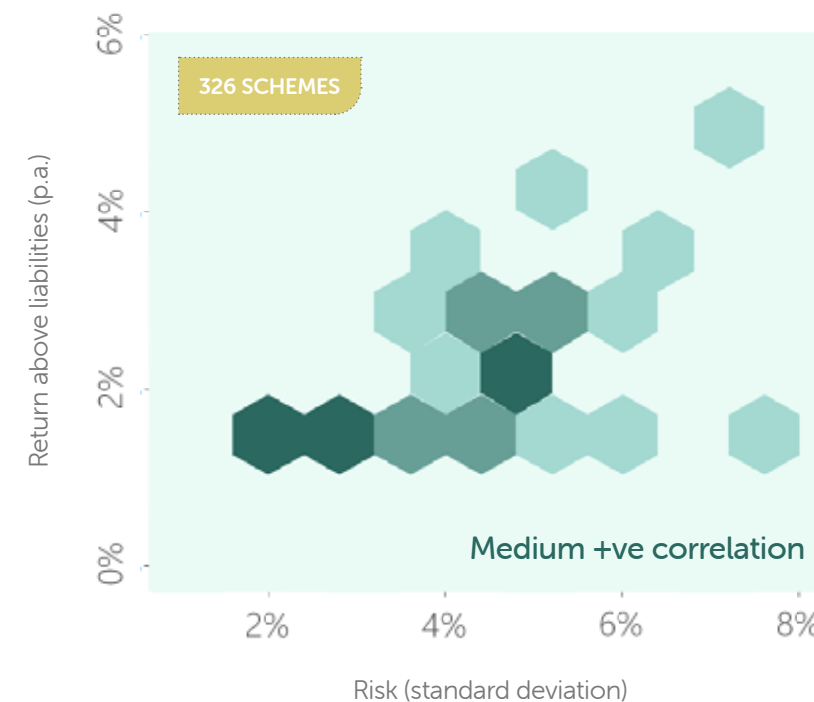


FIGURE 7 – RISK-RETURN RELATIONSHIP OF FM MANDATES IN THE 5 YEARS TO 31 DEC 2020



Longer-term performance also raises some interesting considerations.

Both of [Figures 6 and 7](#) show the range of outperformance for low return targeting mandates is very narrow and managers have not been rewarded by taking more risk. This poses the question as to how much value FM adds, from purely an investment perspective, for pension funds which are heavily de-risked. There may still be governance benefits of course, in which case the spotlight should be on the overall costs of a FM approach.

For medium and high return targeting mandates, the long-term relationship between risk and return is reassuringly stronger than what we witnessed in 2020 isolation. For medium return targeting strategies, all managers have on average achieved their outperformance objectives, which is a very good result for the industry. For high return targeting mandates the picture remains mixed and further supports the importance of fiduciary manager selection and ongoing oversight.

This final chart shows that a wide range of returns across managers can also apply within managers. Here we focus on medium return targeting mandates with unconstrained liability hedging. Eight managers provided data in this category.

Even after taking into account that mandates in the category are targeting different rates of outperformance (between 1.5-2.5%) the variation in returns within some managers is stark.

The difference in dispersion between manager returns highlights the range of portfolio customisation and flexibility between managers.

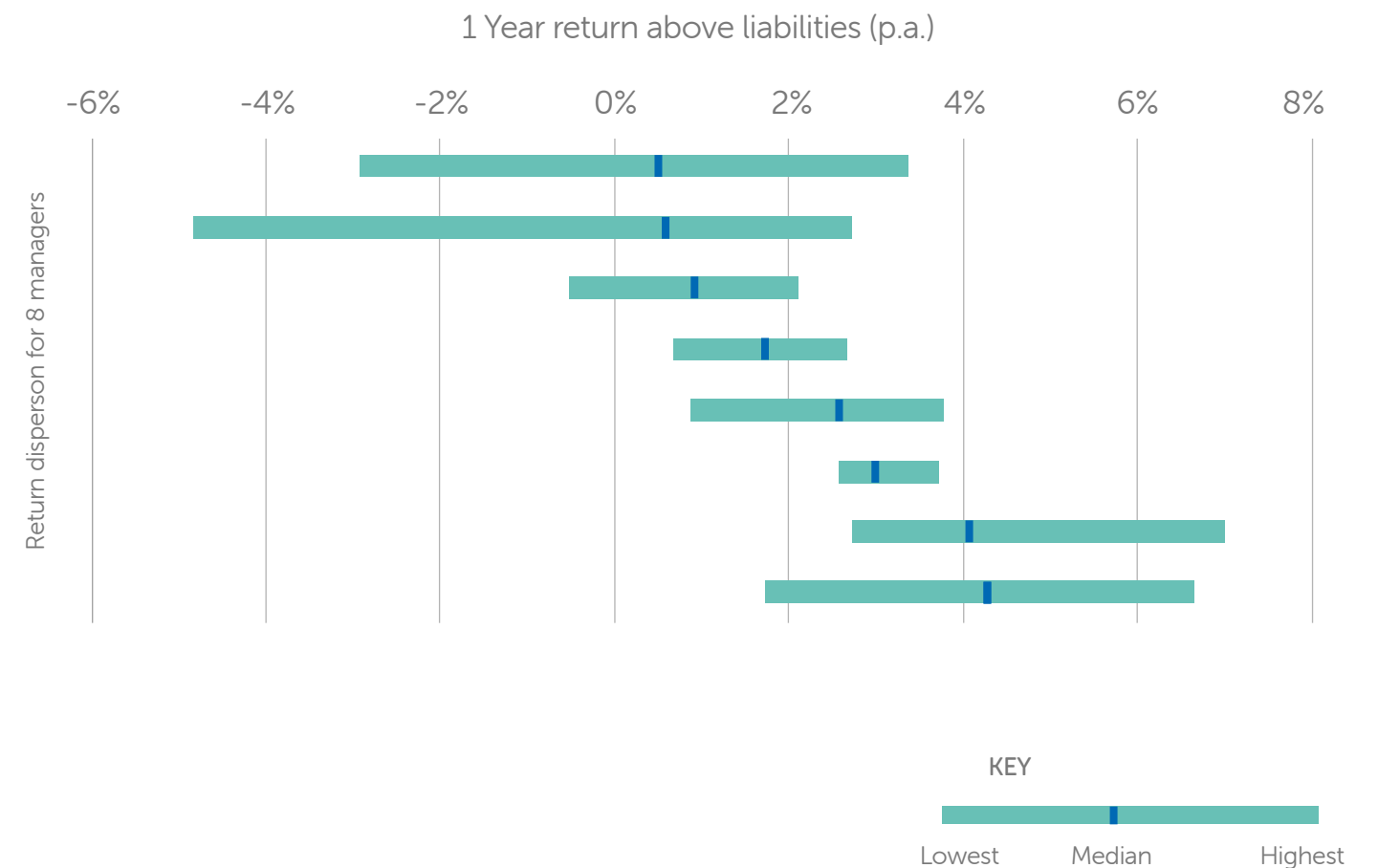
Some managers run model growth portfolios across the majority of their mandates, whereas others offer a highly bespoke approach.

This is a key factor to consider throughout the lifetime of a FM appointment, for example:

- when appointing a fiduciary manager, with implications on a trustee board's ability to influence the portfolio and on cost;
- when defining the FM mandate guidelines and understanding the potential implications for future investment performance; and
- when using this GIPS® for FMPs investment performance data to assess fiduciary manager performance.

FIGURE 8 – EXAMPLE DISPERSION OF INDIVIDUAL MANAGER RETURNS DURING 2020 (MEDIUM RETURN MANDATES)

138 SCHEMES



We give special thanks to the organisations who have taken part in our review and who account for over 90% of UK FM assets under management:

Aon	Mercer
BlackRock	River & Mercantile
BMO Asset Management	Russell Investments
Cardano	Schroders
Charles Stanley	SECOR
Goldman Sachs Asset Management	SEI
Kempen	Willis Towers Watson

Final word on FM investment performance during 2020

The range of investment returns and drawdowns over 2020 demonstrates the financial significance of selecting the right fiduciary manager to fit with your pension fund’s objectives.

We have said for a long time that although the decision to adopt a FM approach should be governance-led, the decision about which fiduciary manager to use should undoubtedly be investment-focussed.

It also emphasises the importance of being able to understand what is driving a pension fund’s investment performance and whether the decisions taken by the fiduciary manager are adding value. Delegating responsibility over all of the assets places greater emphasis on a trustee board’s ability to hold their manager to account.

The advent of the GIPS® for FMPs will provide a valuable new perspective to pension funds, provided it is used in the right way, and supplemented by a more detailed assessment of how returns have been generated.

Using the data

EXPLAINED: FM investment mandate categorisation

The GIPS® for FMPs methodology categorises each FM mandate (or 'composite'):

- Firstly, by its target investment return relative to a pension fund's liabilities;
- Secondly, by any liability hedge restrictions and, at each manager's discretion, any other asset restrictions⁵.

Most pension fund mandates are categorised only by target investment and any liability hedging restrictions. We note, under a fiduciary management contract, it is possible for trustees to impose additional asset restrictions. In this review, we have excluded those pension funds with scheme specific asset restrictions from the analysis.

TARGET INVESTMENT RETURN CATEGORIES:

- A. Liabilities + $0\% < x \leq 0.5\%$
- B. Liabilities + $0.5\% < x \leq 1.5\%$
- C. Liabilities + $1.5\% < x \leq 2.5\%$
- D. Liabilities + $2.5\% < x \leq 3.5\%$
- E. Liabilities + $x > 3.5\%$

LIABILITY HEDGE RESTRICTION CATEGORIES:

- 1. Unconstrained hedging
- 2. Hedge restriction $0\% \leq x < 40\%$
- 3. Hedge restriction $40\% \leq x < 60\%$
- 4. Hedge restriction $60\% \leq x < 80\%$
- 5. Hedge restriction $80\% \leq x \leq 100\%$
- 6. Hedge restriction $x > 100\%$

Using the data for analysing FM performance

Establishing a standardised methodology for measuring FM performance was one of the many positive outcomes of the CMA Review. It allows pension funds to compare and contrast performance which is more relevant to its own circumstances. We believe the data is useful to make high-level performance observations as we have done in this paper.

However, the categorisation and associated methodology do create some limitations.

We would encourage users of the data to be cautious in how the data is used to directly compare the performance of different fiduciary managers for a given category, or directly compare their own pension fund's performance against individual manager data.

Click the (+) in the [online interactive version](#) of the study on our website for important information to be aware of when using this performance data.

Key issues to be aware of are:



www.barnett-waddingham.co.uk

Barnett Waddingham sits on the GIPS® for FMPs Technical Committee. We are leading providers of fiduciary management oversight and evaluation services to UK pension funds.

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Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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Our main areas of expertise are:



selection of a fiduciary manager (including both full assets or partial mandates)



reviewing the fiduciary manager's investment mandate and investment agreement



ongoing monitoring and scrutiny of the fiduciary manager's investment performance and activity



periodic reviews of manager performance and suitability



training trustees on investment governance and delegation models, including fiduciary management

