

INVESTMENT ADVISORY

2014 KPMG UK Fiduciary Management Market Survey

November 2014

kpmg.com/uk





The survey results presented are based on the responses we received from 13 of the more established fiduciary managers operating in the UK market, with data as at 30 June 2014.

We would like to thank all participating providers again for their ongoing support of our attempt to provide clear insight to the UK fiduciary management market.

- Aon Hewitt
- BlackRock
- Cambridge Associates (new to the survey this year)
- Cardano
- Charles Stanley Pan Asset (previously included as Evercore Pan Asset)
- Goldman Sachs Asset Management
- JLT (new to the survey this year)
- Mercer
- MN
- P Solve
- Russell Investments
- SEI
- Towers Watson

MARKET INSIGHT

Size of the Fiduciary Management ("FM") Market

5% of UK Defined Benefit schemes are now using fully delegated FM (over 8% including partially delegated solutions), representing 3.4% of DB assets.

Growth remained strong over 2014 but was driven by new entrants to the provider market, while established players experienced growth at similar rates to 2013. The market has a majority of fully delegated mandates (60%).

How many schemes are using fully delegated FM?

Over 300 schemes are now using FM on a full delegation basis, representing growth of 44% in the number of mandates over 2014. This was primarily driven by a new entrant to the survey this year – excluding this provider, mandate growth over the year was 16%.

This continues to be driven by implemented consultants who won a large number of small mandates over the year. The market remains dominated by these smaller schemes, with 89% of mandates having less than £250m in assets.

Competition between fiduciary managers

There continues to be relatively little competition in the tendering process in the FM market with over 80% of new mandates over the year won on an "uncontested basis" – without a fee quote from an alternative provider.

To date there has been a lack of 'switching' between FM providers by schemes, with only three reported switches. However, over 100 schemes have now been using FM on a fully delegated basis for over 3 years, so we would expect this to increase as a consequence of trustees' "triennial FM reviews".

Overseeing the fiduciary manager

Over the last year more mandates appointed independent advisors, rising from 24 in 2013 to 32. This was more common amongst the larger schemes.

Two numbers stand out to me in the 2014 Fiduciary Management (FM) Survey. The first is the astonishing 44% growth in the number of full delegation FM mandates over the year. The second is that of these 92 new mandates, over 80% of them were won on an uncontested basis – in other words: in 8 out of 10 cases a quote was only provided by the ultimate mandate winner.

The 44% mandate growth is substantially attributable to a new entrant to the market, who largely converted an existing client base from a previously directive consulting approach onto a new fiduciary platform, highlighting the fact that this is not a mature market: to date only 5% of UK Defined Benefit Schemes use fully delegated Fiduciary Management.

However, the number of mandates won without a competitive tender process remains uncomfortably high. Without such a process trustees risk not getting the delegation solution that best matches their needs.

A third number that is remarkable - but by its absence - is the investment performance of the Fiduciary Management industry over the year. Here there are two problems: firstly, not all Fiduciary Managers will share their performance data; secondly, there is no consensus in the industry about how performance should be judged even when it is available. The result is that it is unfortunately not yet possible to say how the FM market has performed.

With over 100 UK defined benefit schemes having now built up an FM performance history of 3 years or more we fully expect many more schemes to individually assess the performance of their FM manager in the upcoming year. The challenge for those schemes will be understanding how their FM compares to others, a challenge which we feel Fiduciary Managers could and should do more to address.

For further discussions, please feel free to contact me.

Anthony Webb

November 2014

Head of Fiduciary Management Research

THE FM MARKET

What is “Fiduciary Management”?

FM is a broad concept used to describe the delegation of investment decisions, previously taken by trustees, to a fiduciary manager (the ‘provider’).

The provider typically manages the delegated assets on their platform on behalf of the trustees and the extent to which decisions and assets are delegated can vary significantly between schemes.

In order to provide consistency in our market analysis over the years, we have developed definitions around what we consider to be ‘full’ delegation and ‘partial’ delegation.

There are also three provider subsets in the market, arising from the original business models which have evolved to offer fiduciary services in the market. These are the implemented consultants, specialist providers and investment managers.

Please refer to the Appendix for our definitions of full and partial delegation and the provider types.



Total number of mandates average annual growth over the last 7 years

36% p.a ↑



2014 year-on-year increase in total mandates — (or 19% excluding new providers to market)

47% ↑



Majority of mandates are now managed on a fully delegated basis

c. 60%



UK defined Benefit pension schemes now using full FM

5% (3.4% of UK DB assets)



Fully delegated AUM average annual growth since 2007

52% p.a ↑



FIGURE 1: Market growth by number of mandates

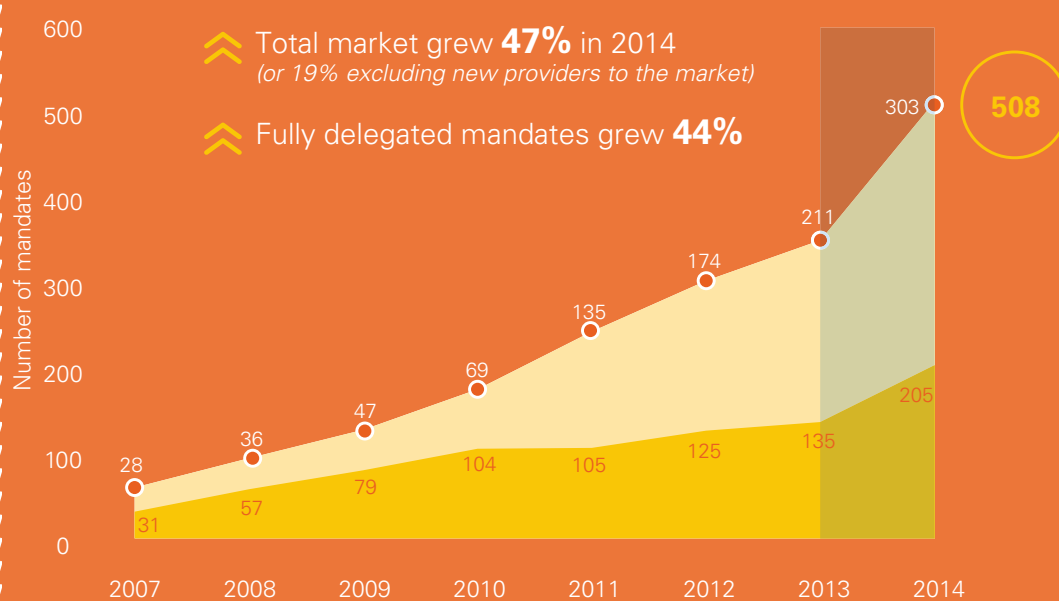
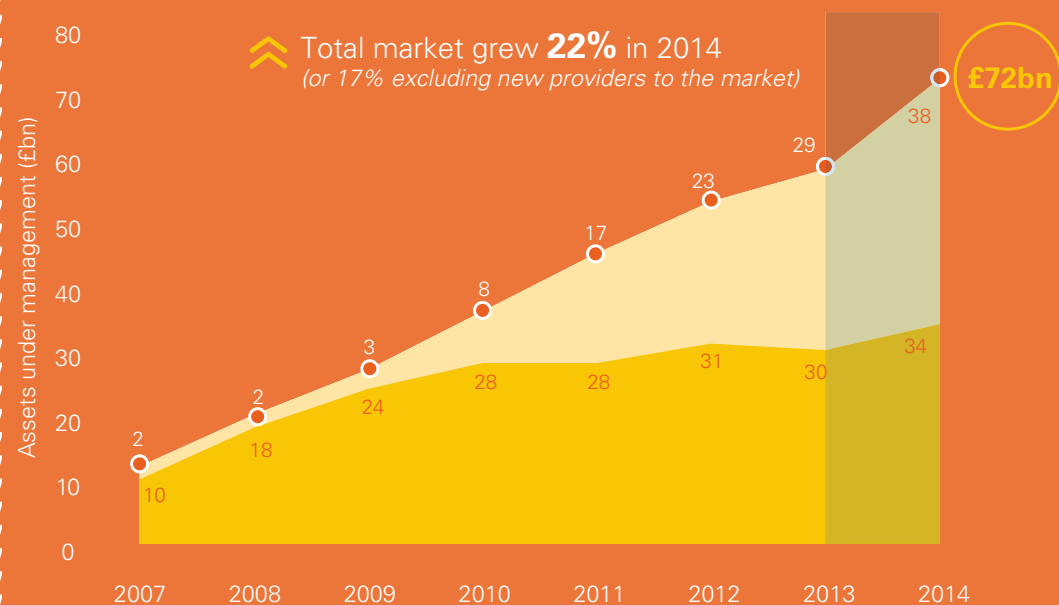


FIGURE 2: Market growth by AUM



PARTIAL MANDATES

FULL MANDATES

HOW MANY SCHEMES ARE USING "FULL" FM?

Just over **300** schemes were using **fully delegated** FM in 2014. This is **5%** of all DB schemes, and equates to **3.4%** of UK DB pension scheme assets*.

- This is an increase of 44% since 2013
- The implemented consultants saw the largest increase in mandates
- This was largely driven by the arrival of a new implemented consultant entering the market, bringing in a significant number of smaller mandates over the year. Without the new entrant the increase in the number of mandates was 16%
- Investment managers and specialist providers won a small number of larger mandates (>£500m)

FIGURE 3: Number of full delegation mandates split by provider type

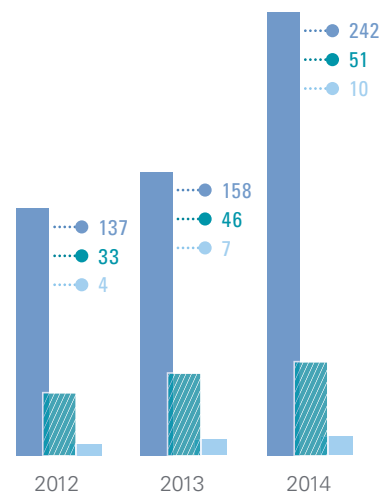
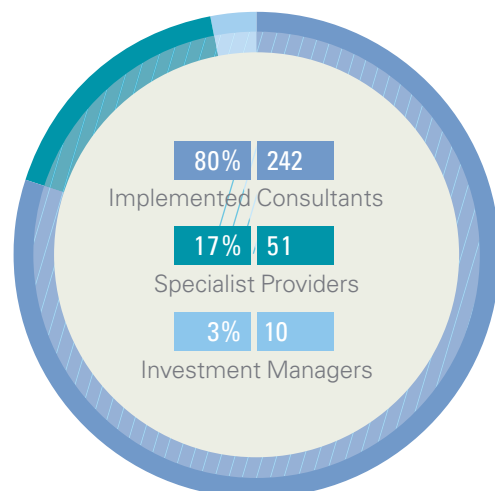


FIGURE 4: Proportion of full delegation mandates split by provider type as at 30 June 2014



KEY: IMPLEMENTED CONSULTANTS
SPECIALIST PROVIDERS
INVESTMENT MANAGERS

303 full delegation mandates at 30 June 2014

44% growth in full delegation mandates over the year

*Source: The Purple Book, 2014

FIGURE 5: The proportion of the AUM within the full delegation market

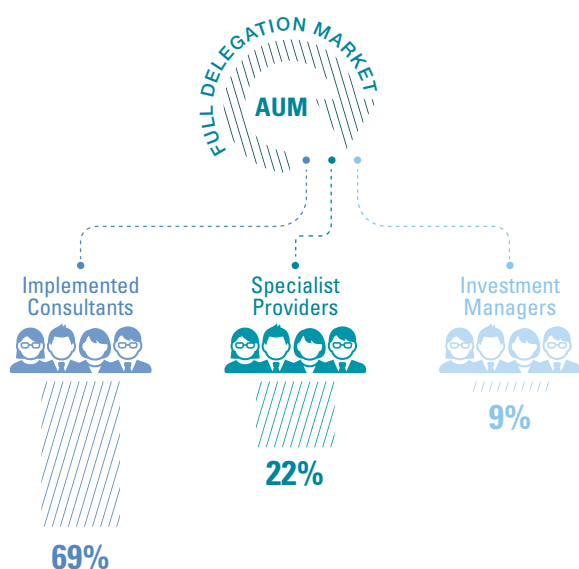
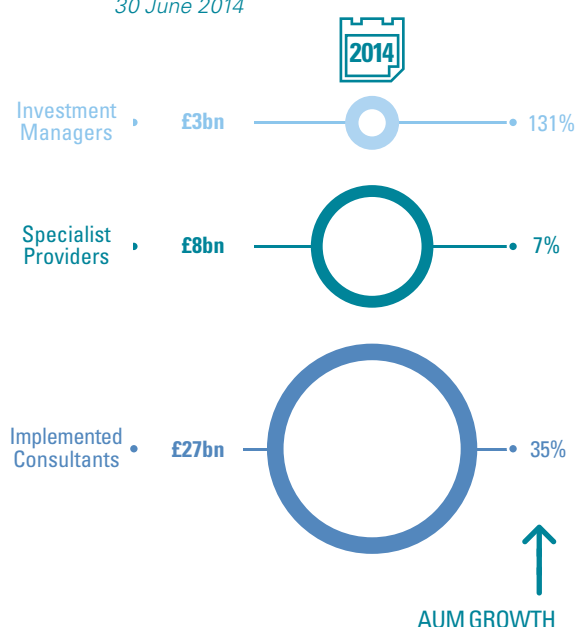


FIGURE 6: AUM split by provider type as at 30 June 2014



- Growth in assets was lower than the growth of number of mandates, indicating a **move towards smaller new mandate sizes**
- Investment managers grew their assets by over 100% by taking on large mandates
- Implemented consultants' growth was driven by a large number of smaller mandates
- Specialist providers grew assets by 7%

£38bn AUM
under full
delegation at
30 June 2014,
representing
31% growth
over the year

- FM still appears to be more common for smaller schemes than for larger schemes in the UK market
- 68% of FM mandates fall in the <£100m bucket, compared to UK DB market where approximately 59% of schemes are <£100m
- **77% of the new mandates** in 2014 were **under £100m**
- **89% of mandates now have less than £250m in AUM** - but more of these are below £100m than in 2013
- Implemented consultants increased their number of mandates **<£100m by 61%** over the year
- The 70 new mandates in the <£100m bucket added approximately £1bn in assets*

89% of mandates have less than £250m in AUM

FIGURE 7: Mandates split by mandate size

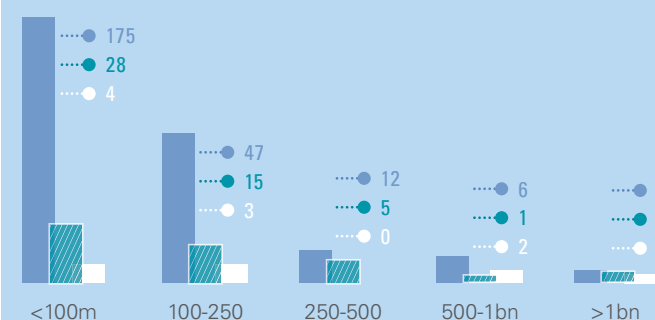
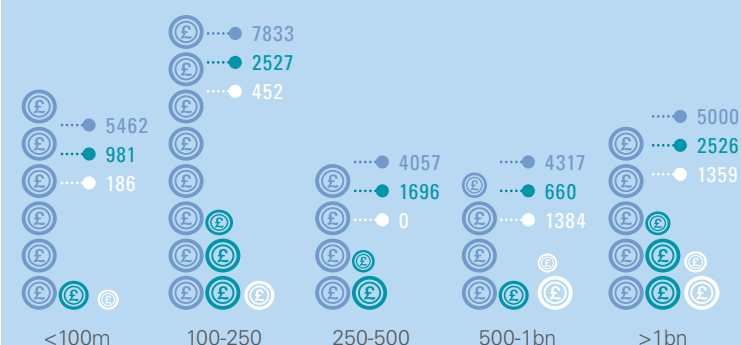


FIGURE 8: Provider AUM split by mandate size



KEY: IMPLEMENTED CONSULTANTS
SPECIALIST PROVIDERS
INVESTMENT MANAGERS

*takes into account expected growth for existing schemes over the last 12 months, based on a strategy of 60% bonds, 40% equity

HOW HAS FIDUCIARY MANAGEMENT PERFORMED?

Put simply: **we don't know.**

Most fiduciary managers have now built up a performance track record of several years. Individual schemes can request performance data from their provider and determine whether or not they are achieving their objectives.

However, **there is still no consensus on how to combine performance across all of a provider's mandates**, and thereby enable a comparison of the "added value" of one fiduciary manager to another. Partly as a result of this, not all fiduciary managers are willing to share their full performance history.

This means that it is not possible for us to say whether or not FM has improved investment performance in the UK pensions market.

Of course, **the key motivation for appointing a fiduciary manager is often driven by other factors than simply improving investment performance.** Nevertheless, reasonable investment performance is an important aspect of the mandate.

For illustration only

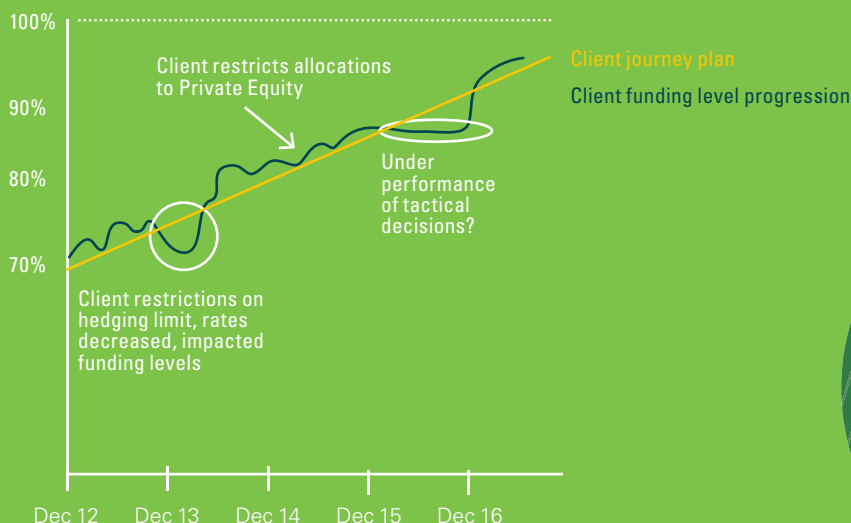


Illustration of how funding level progression against the journey plan is client specific and impacted by any client restrictions placed on the fiduciary manager.

There is still no industry consensus on how best to show combined performance

HOW MANY SCHEMES ARE USING "PARTIAL" FM?

The partial delegation market encompasses a number of different delegation methods and can overlap with other investment approaches such as using a Diversified Growth Fund.

For clarity, we have only surveyed partial FM mandates if they are being offered by a fiduciary manager.

- We have identified three main forms of partial delegation being offered in the fiduciary management space: 'growth portfolio', 'single asset class' and 'horizontal slice'. Definitions of each are included in the appendix.
- Trustees are increasingly comfortable in delegating larger portions of the scheme to fiduciary managers
- This is shown by the **11% increase in the share of growth portfolio mandates**
- Some of this increase may drive future growth of full delegation mandates if liability management is added to the growth portfolio mandates
- Single asset class mandates lost 12% of the market share

205 partial delegation mandates at 30 June 2014

52% growth in partial delegation mandates over the year

FIGURE 9: 2013 market

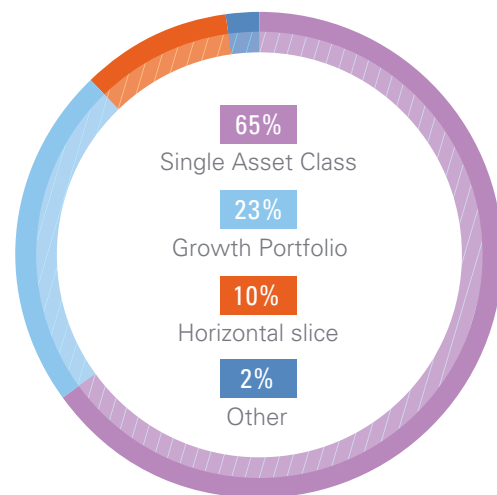
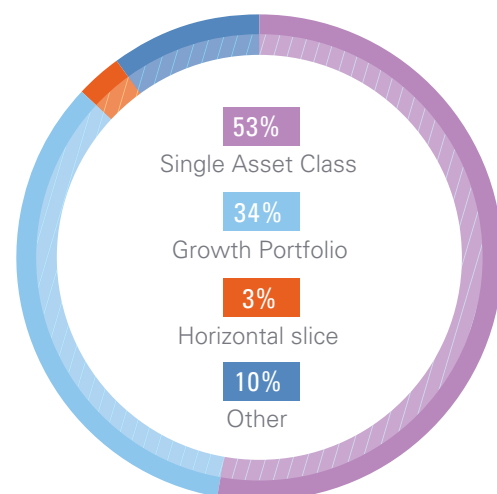


FIGURE 10: 2014 market



OVERSEEING THE FIDUCIARY MANAGER

The percentage of mandates using an ongoing independent advisor has remained stable: 11% vs 11% in 2013.

Larger schemes are more likely than smaller schemes to appoint an independent advisor to provide ongoing monitoring of the fiduciary manager.



KPMG view

We believe that trustees should use an independent overseer of their fiduciary manager to provide constructive independent advice – on whether the provider is sticking to their guidelines, whether they continue to offer a robust service, and whether they are in or out of line with the rest of the FM market. We believe that independent advice can help you to get the most out of your fiduciary manager.

Figure 11: Percentage of Full Delegation Mandates with Independent Advisors - 2014

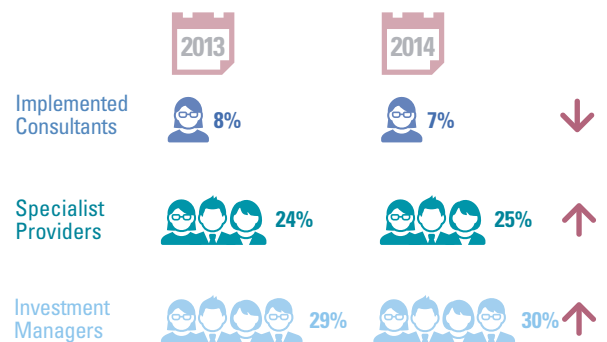
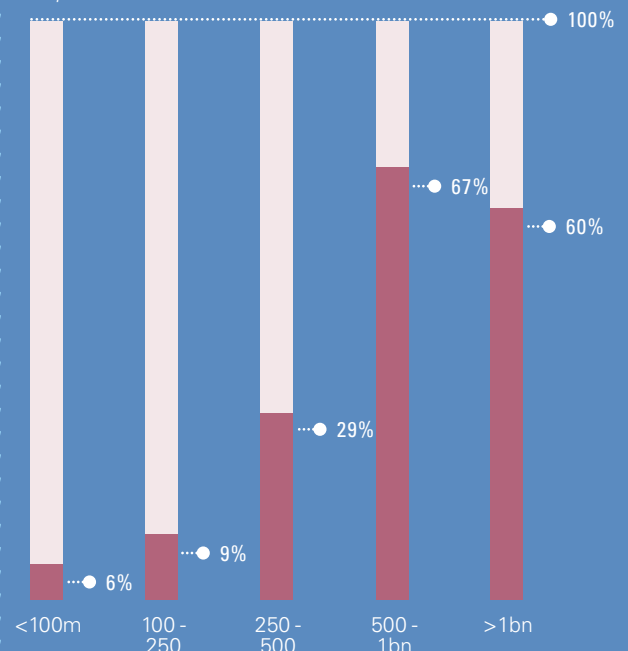


Figure 12: Proportion of each mandate size tranche using an independent advisor in 2014



Larger schemes
are the most
likely to use an
independent
advisor

COMPETITION BETWEEN FIDUCIARY MANAGERS

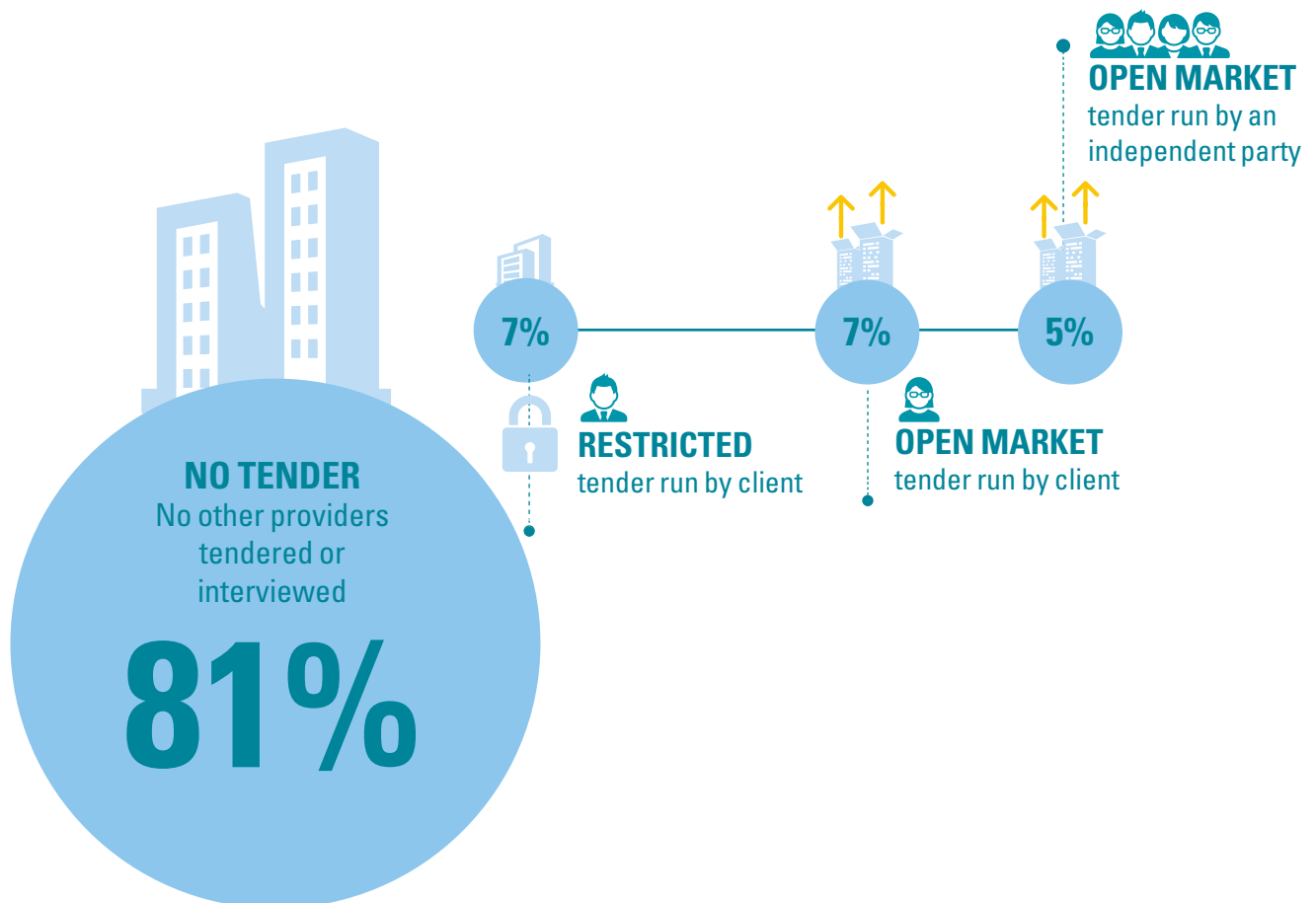
- **81%** of new mandates won over 2014 were done so **without** some form of tender process
- Of the mandates won by Implemented Consultants, **only 11% were through a competitive tender** process

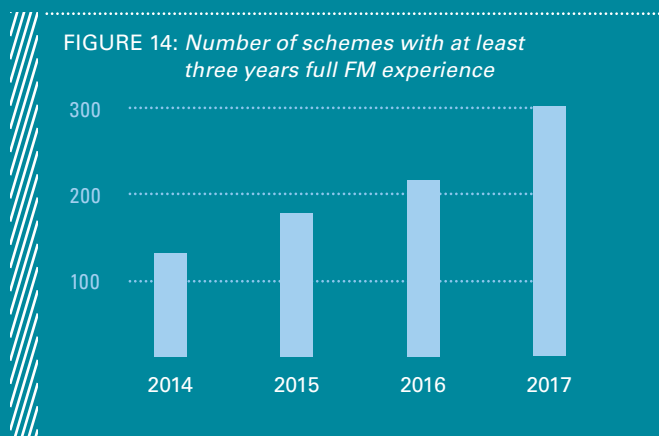
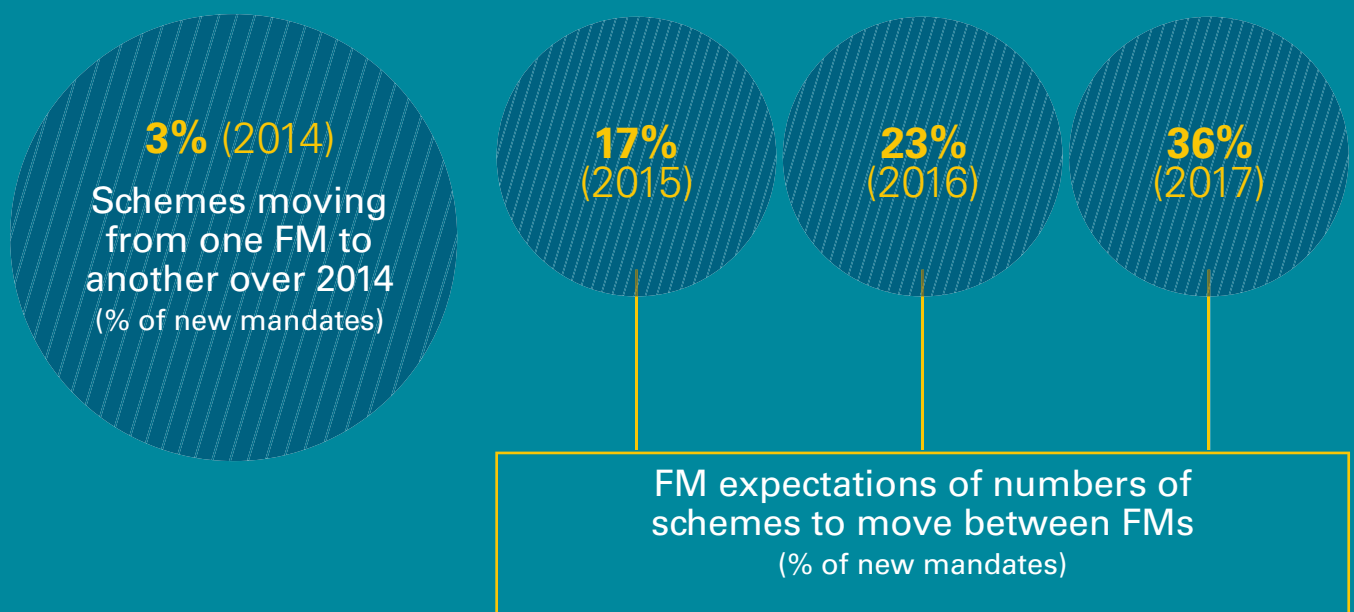


KPMG view

Appointing a fiduciary manager is different to appointing a traditional investment advisor. You receive a different service that needs a different (broader) range of skills. Therefore comparing a number of fiduciary managers is crucial to make sure that you are establishing the right long term relationship. We believe that working with an independent advisor will help you get the best understanding of the current market and the differences between providers, helping you to make the most informed choice.

FIGURE 13: Competitiveness of all new mandates won in 2014





2014 saw the first schemes moving from one provider to another. As schemes who have been using FM for three years or more undertake reviews, this number is expected to grow.

Note: Calculated using the loss rate from 2014. As mandates reach maturity / buy-out positions some of these FM mandates will naturally mature.

CASE STUDIES

One of the most useful tools for trustees considering going down an FM route is the past experience of schemes who have already adopted FM. We interviewed two schemes to highlight key considerations trustees should make:



A large closed, UK, defined benefit Pension Plan

Interview with: the Chairman (an Independent Trustee)

What process did you use to select your FM?

The Trustees and Company were conscious that appointing a fiduciary manager would be a huge decision and we therefore wanted to use a very thorough selection process. We invited various providers to train the Trustees on the concept of FM and also appointed an independent advisor to oversee the selection and implementation process. We then undertook a full market review. The interviews were conducted over 3 stages, with the final interview including a role play session to mimic a typical quarterly meeting, so we had a real feel for how the relationship would work.

How smooth was the process to implement the FM mandate and transition to the new platform?

The overall implementation process was in line with our expectations. However, we did revise the benchmark initially set up to measure the manager's performance to reduce the risk and to adopt a full fiduciary approach whereby the provider is measured against our flight path. The provider was very flexible in responding to the changing goal posts – we have generally been pleasantly surprised by their ability to react to our changes.

Where did you find the independent advice most useful?

We do not think we could have done such a rigorous search process without independent advice. The reality is that the cost of change to an FM is enormous and therefore we thought that having an independent adviser would be money well spent. We also found the document review during the initial implementation stage a valuable exercise as it is crucial to set up the mandate properly from the beginning. We now employ an independent advisor to monitor the FM and provide challenge on an ongoing basis.

What advice would you give to other trustees considering a move to FM?

- The best independent advice we received was to choose a provider with an approach that matched our requirements. This didn't necessarily mean a certain type of provider or the same consultant we had used for our traditional advice as the role of FM is very different to the traditional structure.
- The Company and Trustees must work together throughout the process to help avoid conflicts down the line.
- Think carefully about the concept first to make sure the Trustees are comfortable with the increased delegation of FM.
- Be prepared to spend a lot of time on the process and hire independent advice if appropriate.



Asda Group Pension Scheme

Interview with: Steve Jones (Company) & Richard Phillips (Chair of the Trustees)

What were the most important differentiators between the FMs you considered, when making your selection?

We felt that our chosen FM manager stood out as really believing in fiduciary management and being committed to the business as well as having strong capabilities in hedging interest rate and inflation exposures. We also thought it was important to have a manager who could communicate effectively, and clearly explain the rationale for their positioning.

How would you assess your FM's performance so far?

It took a while to get fully invested but since then the manager has done what they said they would do and with relatively little volatility. The time spent setting parameters at the start of the mandate was valuable. We also find that the manager is very responsive, always available and has a transparent process – this has been almost as important as the performance itself.

How do you monitor the FM?

Although we have a strong working relationship with the client lead at the FM, it is very useful to have an independent advisor who can challenge the manager in a constructive and collaborative way. This independent relationship works better than we had expected because they are not obstructive to the manager. The independent advisor also stops us being too “smug” after periods of good performance, by providing perspective.

What advice would you give to other trustees considering a move to FM?

- Choose a manager who really believes in FM and has conviction in what they are doing.
- Recognise that understanding the FM's process and what they are doing is important.
- Consider the need for ongoing independent advice to enable you to understand and challenge performance.

KPMG FM ADVISORY SERVICES

Description of Services

KPMG's fiduciary management advisory service for pension schemes combines investment consulting experience, with firm wide audit and internal controls expertise.

Because KPMG does not provide fiduciary management services or investment management services we are able to offer completely independent advice to pension schemes.

KPMG can provide advice on all aspects of the fiduciary management, including:

Advice on selecting a fiduciary manager

Different fiduciary managers suit different pension schemes. We provide advice to trustees from the initial stages on how to refine their criteria for selecting a fiduciary manager, right through to assisting trustees in fiduciary manager beauty parades

Ongoing monitoring of your fiduciary manager

We help trustees get the most out of their fiduciary manager by providing challenge where necessary and by providing an independent assessment of the progress of the FM against their objectives

Advice on investment governance structures

This is most useful for pensions trustees who would like help deciding whether or not FM – or other investment governance structures – is right for them

Fiduciary management mandate and guideline setup advice

Setting up the mandate correctly is crucial when commencing fiduciary management. This will control what the fiduciary manager can and can't do, and provide the framework against which to measure their ongoing success. We help trustees in their discussions with their fiduciary managers

A "one off" assessment of your fiduciary manager

For trustees who do not use ongoing monitoring of their fiduciary manager we are able to provide a "one off" review of the fiduciary manager, assessing their progress since inception and providing insight into the capabilities of the fiduciary manager

Further details on our services and on FM in general can be found on our website at:
www.kpmg.com/uk/en/services/tax/pensions/pages/fiduciary_management_advisory.aspx

APPENDIX - DEFINITIONS

Mandate definitions

KPMG uses the following mandate definitions for FM appointments within the UK market:

Full Delegation: An FM manager provides the full delegated service and is engaged under an investment management agreement to manage 100% of scheme assets. Full delegation typically includes all, or most of: journey plan design; strategic and tactical asset allocation; growth and matching portfolio structuring; investment manager selection, implementation and administration.

There can be different degrees to which schemes delegate away their investment responsibilities. For example, 'full delegation' can range from managing to a funding level/liability return target within a prescribed timeframe (journey plan approach), to giving the FM a strategic benchmark which they have freedom to invest around (strategic benchmark approach). We consider both forms to be 'fully' delegated portfolios if the FM takes responsibility for both assets and liability risk management and has discretion to flex their allocations, in line with the investment guidelines, without requiring trustee approval.

Partial Delegation: Trustees delegate only a subset of investment management to the FM provider, for example only a portion of the scheme assets or only certain responsibilities are delegated, such as growth portfolio management, tactical asset allocation or manager selection. The partial delegation assets under management reflect only the assets delegated.

FM providers

KPMG defines the following three subsets for FM providers within the UK market:

Implemented Consultants: Investment consultancy practices that have evolved their business model from pure advisory to an implemented consulting (i.e. implementing portfolios and executing transitions on behalf of trustees more similar to asset management businesses). These providers have developed fiduciary management platforms leveraging from their fund manager research functions, expertise in strategic asset allocation and knowledge of the trustee market.

Specialist Providers: There are a number of FM providers in the UK market for which fiduciary management is a primary function within their business – for some providers this is a sole focus. These providers benefit from alignment of interest and exclusive focus on developing, delivering and managing FM solutions for pension scheme clients.

Investment Managers: Within the UK FM market there are a number of investment managers that offer FM solutions. These asset managers have typically developed FM out of their multi-asset class investment capabilities and are experienced within the UK pensions market. These providers make use of their investment market understanding, in house client servicing, risk analysis capability and auxiliary functions (i.e. administration, back office functions etc).

Competitive tender for Fiduciary Manager selection

A tender process in which the client is reasonably believed (by the winning Fiduciary Manager) to have received a fee quote from at least one other Fiduciary Manager, in addition to the winning Fiduciary Manager.

Forms of partial delegation offered by survey respondents

Growth portfolio delegation: In this variation of partial delegation, trustees only delegate their growth assets to the FM provider. Often this uses the FM provider's pooled growth fund, which is not dissimilar to the concept of a diversified growth fund. Where some clients can see the benefits of FM, but are not comfortable with a full delegation mandate, we have seen this approach being taken up. This is driven by the desire to reduce the governance burden of the growth portfolio and make use of expertise where trustees see potential for this to add value to their investment growth.

Single asset class: In this variation the fiduciary manager is appointed to manage a specific asset class or investment mandate. Typically, we have seen these mandates tendered for asset classes where the trustee has limited knowledge or expertise, such as alternatives, which is often where in house management is available across other assets classes apart from these. Some trustees view these mandates as the first step towards a full fiduciary solution in the future.

Horizontal slice: A less common approach we have seen is where a subset of the Scheme's assets is outsourced to a fiduciary manager; they will then manage against the liabilities – i.e. a percentage of the Scheme would be delegated. We have seen this approach when clients wish to 'dip their toe in the water' with FM.

Interestingly, a horizontal slice approach is used in other geographies, such as the US, more frequently than in the UK. We note that this approach is sometimes used to run two FMs against each other, or to allow an in house team to have access to a FM's research and trade ideas.

Other: We recognise that there are various appointment structures that fall into the partial delegation category of FM. We have defined the specific approaches we have experience of above, as we recognise these to be the main variations of the partial delegation approaches adopted in the UK FM market today.

NOTES ON METHODOLOGY

Similarly to last year, one provider was unable to provide the same level of granularity of data as in previous years. They have provided headline information but for the following items we have had to scale up their results in the same proportion as in the 2012 survey, when they last provided this data:

- Breakdowns of mandates / AUM by mandate size
- Number of pitches / selections over the past 12 months
- Breakdown of partial delegation mandate types
- Engagement of independent advice
- Competitiveness of fiduciary appointments.

We do not consider these approximations to be material to the results of the survey.



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