XPS Group

April 2025

Investment Briefing

How well are fiduciary managers adapting to improved scheme funding?

Fiduciary Management (FM) has been a popular governance option for pension schemes, growing to around 15-20% using it to some degree today. In this briefing, we highlight the environment pension schemes were in that led to the popularity of FM, the impact of improved funding levels and changing journey plans on fiduciary managers, and the structural challenges some face in adapting to this new environment because of the way they have built their offerings.

Having analysed over 100 FM mandates, significant fee savings in excess of £150,000 per annum for a £100m scheme could typically be achieved where the well-funded scheme can implement a simple investment strategy using a traditional advisory approach - this equates to a funding improvement of around 1% every 5 years. As such, we believe it is right for schemes that use FM to review whether it remains appropriate and good value for money.

Market at a glance

The FM industry has grown strongly since it was introduced into the UK pensions market in the 2000s. It has been employed by schemes of all sizes, with even multi-billion pound schemes adopting it.

15-20%	of UK pension schemes using FM in some form
>1000	FM mandates in 2024 compared to 400 in 2015
c.70%	of mandates less than £100m in assets under management
c.50%	of mandates managed by fiduciary manager with consulting heritage

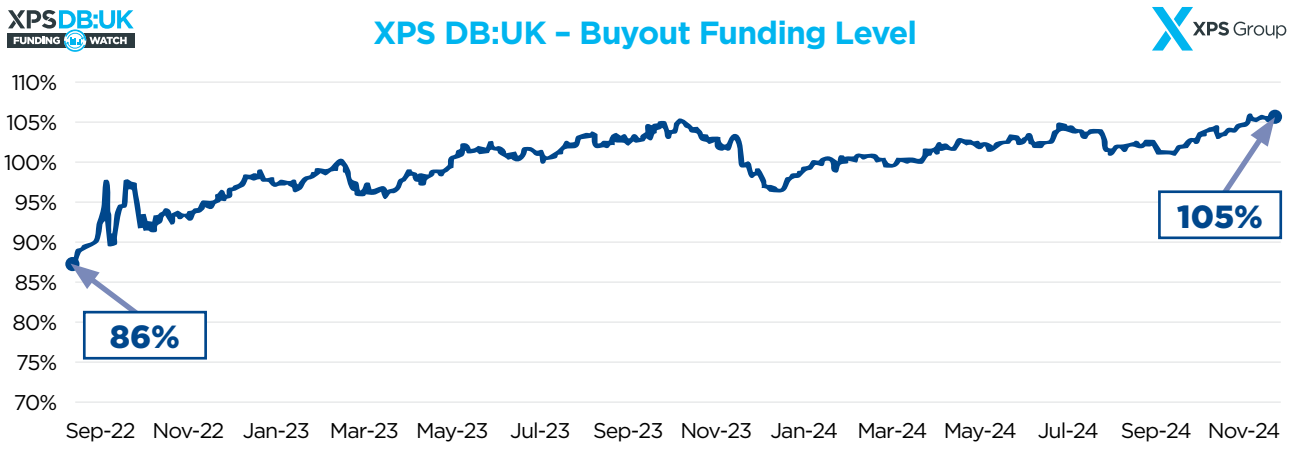
The primary reasons pension schemes tended to adopt a FM approach were:

- **Deficit recovery** - In the past, many pension schemes had significant deficits which demanded relatively high levels of investment return to help repair. Seeking high returns in a risk-managed way requires a number of skills that not all trustees possess (or have time available to devote), such as seeking and evaluating investment opportunities, changing asset allocation dynamically and diversifying across many asset classes to reduce investment risks.
- **Governance & complexity** - Pension scheme investments have become increasingly complex, including areas such as liability driven investment ("LDI") and more esoteric illiquid assets. FM offered the promise of expert, dedicated professionals taking some of this governance burden off the shoulders of trustees.
- **Supporting de-risking** - As their funding levels improved, many pension schemes wished to reduce investment risk (and returns) to "lock-in" these improvements - sometimes known as "dynamic de-risking". This (often) involves daily monitoring of the funding position and the ability to take rapid action once a de-risking opportunity has been identified. Some trustees have preferred to delegate this time-consuming activity to a fiduciary manager.

Total investment management fees (i.e. the fiduciary manager's fees and the fees of the underlying managers) is often higher (sometimes materially so) if using FM versus the alternative of a traditional advisory approach, as recompense for delivering the above. This will not be news to trustees who use FM, as they will have judged in the past that the benefits of FM mentioned above make up for the additional fees.

The impact of improved funding levels

In recent years, global equity markets have delivered strong returns. Coupling this with the material increase in gilt yields has significantly improved the funding levels of many pension schemes.



Source: XPS Group. The data in the charts above incorporate data from The Pensions Regulator, the PPF 7800 Index and the XPS data pool.

Since originally adopting FM, many schemes that find themselves well-funded on a prudent basis (e.g. buy-out) have seen their needs shift and no longer require high return, complex, investment strategies or dynamic strategies. Such a strong funding position is likely better suited to a portfolio of LDI/gilts, investment grade credit and other low risk assets **(especially if a buy-in transaction is your end goal).**

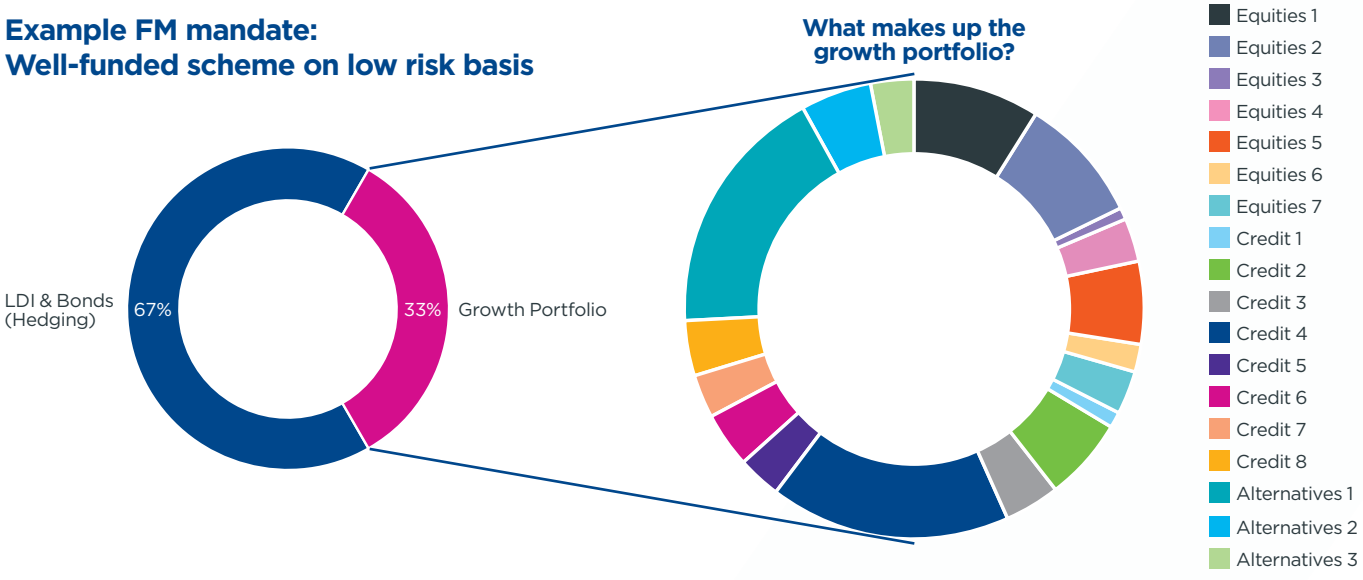
Such a portfolio comes with **simplicity** and the potential for **material fee savings** under an advisory approach, with a simple fund manager structure, when compared to FM. Whilst trustee governance requirements would be slightly increased, this would not be onerous (especially where there is a professional independent trustee in place) for a simple, low risk, investment strategy which is expected to remain relatively static.

Many fiduciary managers have been slow to adapt to these changing scheme circumstances and we have witnessed numerous examples of overly complex investment strategies remaining the norm, or restrictive "building block" approaches not allowing sufficient tailoring of a scheme's investments to be simplified within an FM mandate.

We've seen many cases where the lower cost of a non-FM approach versus FM improves the funding position of the scheme by 1% every 5 years.

Considering this fundamental shift in circumstances, and the significant potential difference in costs, we strongly believe that all schemes that use FM should reassess whether it remains aligned to what they are trying to achieve today and ensuring that it is delivering value for money.

Example FM mandate:
Well-funded scheme on low risk basis



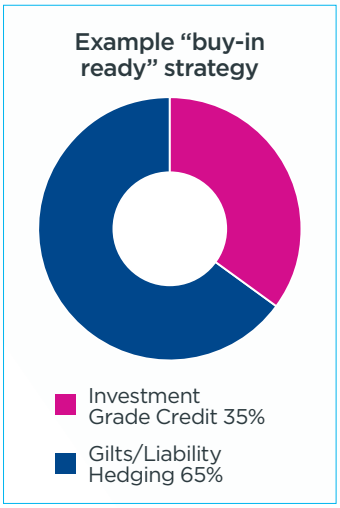
The impact of FM for schemes looking to buy-in

Many schemes that are well funded and preparing to transact a buy-in look to broadly align a portfolio with changes in insurer pricing. It is not possible to do this perfectly, but a broad match would be a portfolio consisting of gilts and investment grade credit.

This is a simple, low fee, low governance portfolio which may not benefit from the "added-value" features available under FM at a higher cost.

We have seen many instances where schemes using FM are well funded on a buy-out measure, but still have material allocations to growth assets, which can threaten a buy-in transaction for 2 key reasons 1) **A surplus can become a deficit** if a large proportion of the portfolio is invested in growth assets and markets take a negative turn. 2) **A liquid portfolio is desirable for a buy-in,** and the presence of illiquid assets is likely to cause a headache in the planning and execution of a buy-in transaction.

Inflexibility can arise where a fiduciary manager utilises a "building block" approach, involving switching between a growth fund and matching fund, for example, when changes in asset allocation are appropriate. The make-up of the building blocks cannot be customised, so it's hard for scheme specific requirements to be catered for - e.g. when customisation is required to closely match a price-lock portfolio for a buy-in.



Where transacting a buy-in is a near term target (e.g. within 3 years), it is important that trustees don't sleepwalk into a position of being fully funded (or even in surplus) but still have illiquid assets that you would typically want 2-3 years (or potentially more) to exit.

We strongly encourage a review of your FM arrangement if you are targeting a buy-in within the next 3 years to understand any illiquid assets and formulate a plan for exiting these. The "buy-in ready" portfolio set out above is simple and would incur low management fees, so again, you should be clear of the benefits you expect from FM if costs remain high at this point on your journey, which can be easily assessed as part of any review.

Actions for trustees and sponsors

We believe that now is the right time for trustees to review any FM arrangement given the material improvement in pension scheme funding levels:

1. **Where FM remains attractive** - For less well funded schemes, where FM is already in place, this may remain an attractive option. These schemes that require a higher-returning portfolio may benefit from more complexity that can be delivered in a low governance format for trustees.
2. **Ensure value for money** - For well-funded schemes that are now in a position to run relatively simple, low risk investment strategies, FM has been slow to adapt to the new world, retaining structures geared up for higher returning portfolios with costs to match. There is a danger, therefore, that schemes aren't receiving value for money. Until fiduciary managers create lower cost solutions suitable for the position many schemes now find themselves in, schemes should undertake a review to compare the value-for-money they are receiving from FM versus other aproaches.
3. **Preparing for buy-in** - For schemes targeting a buy-in, we urge that a review is undertaken to ensure your investment strategy is positioned consistently with this objective. An excessive exposure to growth assets could endanger a surplus position if markets take a downturn and illiquid assets could complicate or delay a buy-in. This is particularly pertinent with the equity market volatility which has been experienced year to date.
4. **FM oversight** - Where schemes are expected to continue to use FM for the foreseeable future, we would strongly advocate the appointment of an independent oversight advisor to ensure your fiduciary manager is meeting their objectives and is offering good value for money.

Options to consider from a governance review

Retain current FM approach	Retain current fiduciary manager but adjust approach	Change FM provider	Switch to alternative governance model

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Our investment team advises over 350 clients with assets of over £100bn.

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Professional Pensions UK Pensions Awards 2024 – WINNER – Actuarial/Pensions Consultancy of the Year – XPS Pensions Group

Professional Pensions UK Pensions Awards 2024 – WINNER – Sponsor Covenant / IRM Adviser of the Year – XPS Pensions Group/Penfida

Pensions Age Awards 2024 – WINNER – Sponsor Covenant Provider of the Year

AJ Awards – Software of the Year 2024

Professional Pensions UK Pensions Awards 2022 – WINNER – Actuarial/Pensions Consultancy of the Year – XPS Pensions Group

Professional Pensions UK Pensions Awards 2021 – WINNER – Actuarial/Pensions Consultancy of the Year – XPS Pensions Group

Corporate

Corporate Adviser Awards 23 – WINNER – Best Pension Adviser

Investment consulting

Professional Pensions UK Pensions Awards 2023 – WINNER – Fiduciary Evaluator of the Year – XPS Pensions Group

Professional Pensions UK Pensions Awards 2022 – WINNER – Investment Consultancy of the Year – XPS Pensions Group

Professional Pensions UK Pensions Awards 2021 – WINNER – Investment Consultancy of the Year – XPS Pensions Group

Administration

Professional Pensions UK Pensions Awards 2023 – WINNER – Third-Party Administrator of the Year – XPS Pensions Group

Professional Pensions UK Pensions Awards 2022 – WINNER – Third-Party Administrator of the Year – XPS Pensions Group

Professional Pensions UK Pensions Awards 2020 – WINNER – Third-Party Administrator of the Year – XPS Pensions Group

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Culture and Sustainability

UK Company Culture Awards 2024 Winner – Best Diversity, Equality and Inclusion (DEI) Initiative

Professional Pensions Rising Star Awards 2024 – WINNER – Organisational Award: Award for Supporting Development – XPS Group

Business Culture Awards – Winner 2024 – Working Environments & Practices

Professional Pensions UK Pensions Awards 2023 – WINNER – Diversity & Inclusion Excellence Award – XPS Pensions Group

UK Employee Experience Awards – Gold Award Winner – Employee Engagement

UK Stewardship Code

Disability Confident Leader

Find out more

To discuss any of the issues covered in this edition, please get in touch with Duncan Maloney or Ben Gold. Alternatively, please speak to your usual XPS contact.



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