The Broad Brush

Number 8
March • 2011

A regular analysis of strategic marketing issues in the European investment business

Fiduciary Management
Getting to grips with the finer details

Everyone has heard of Fiduciary Management. It has grown to become a prominent part of the institutional asset management and consulting business in Europe. Big Fiduciary teams in expensive downtown offices are engaged in servicing large pension fund and other clients in 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 ... no one seems entirely clear what it is. Ask any three asset managers, consultants or pension fund professionals for a definition, and you are likely to get three different responses. Ask them how much there is, and where it is, and you will get a wide range of guesses, some more informed than others.

> "No one seems entirely clear what Fiduciary Management is."

This is exactly where we like to come in. Give us something unmeasurable and indefinable, and we will measure and define for you. It may not be the most glamorous way of making a living, but it's what we do best.

In this short piece we pick up on themes that Nigel Birch started to develop in 2009 in our 'Evolution of Fiduciary Management' which (accurately, as it happens) predicted the future shape of the market, through to our pan European research on demand for Fiduciary last year, and then this year to Nigel's pioneering work collecting key data from leading Fiduciary Managers.

We can't share all of our findings with you. Much of our work is confidential. And what isn't, is for sale, so please do make contact to buy our more detailed findings. What we can share here are some quick thoughts on the questions we hear repeated virtually every day:

What on earth is Fiduciary Management?
How much of it is there, and who provides it?
Where does it happen most?
How fast will it grow?

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Investment Marketing Intelligence

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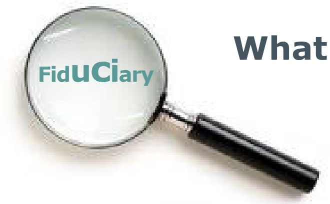
Spence Johnson is a privately-owned specialist provider of marketing intelligence. Its research products and consulting assignments support marketing, sales, and strategic planning in investment based businesses - asset management, life & pensions and wealth management.



Fiduciary Management - Getting to grips with the finer details



What on earth is Fiduciary Management?

A Fiduciary Manager forms a partnership with a pension plan (or another type of institution) with a view to improving governance. The Manager provides strategic advice, is accountable for implementing the overall investment strategy relative to liabilities, and is responsible for day-to-day investment decision-making within pre-agreed guidelines.

There was a time in the early days of Fiduciary Management when a pension fund was expected to 'hand over the keys' to its Fiduciary Manager. Not any more. Now a Fiduciary Management service is a finely balanced partnership between a client organisation and the provider, based around some or all of the long Menu of services we have listed in the top box to the right.

Our research shows that those services or solutions shown at the top of our Menu are most likely to be included in a typical Fiduciary Management appointment, and those at the bottom least likely to be included. We say it is a 'finely balanced' partnership because there will be various degrees of discretion given for various elements of the service.

To qualify as a Fiduciary management appointment, the manager must (as we make clear in our Five Conditions in the bottom box to the right) have at least some discretion over key elements of investment activity, and the scope of the service must encompass all or virtually all of the fund's assets.

It is not good enough to claim (as some firms are rather naughtily doing) that just because they advise a fund to some small extent that this should be called a Fiduciary Management appointment. We have seen some absurd claims for what constitutes Fiduciary Management which we discount when we assess market size.

Part of the problem in defining the service is that no one can yet agree on what to call it. Most people in Europe, including us at Spence Johnson, call it Fiduciary Management. But not everyone agrees with this - that term Fiduciary Management is held (particularly in the Netherlands) to be tainted by the 'key-handing-over' days of yore. So lots of other descriptions have evolved which mean pretty much the same thing, such as Integrated Balance Sheet Management, Delegated Consulting, Implemented Consulting, Solvency Management, Integrated Solutions, Total Integrated Governance Solutions, and Delegated CIO. In the US it is often referred to as Pension or Investment Outsourcing, but many there also call it Fiduciary Management.

Menu of Fiduciary Management services

1 Integrated Reporting (at manager level)
2 Legal and Compliance
3 Advice on investment strategy
4 Asset allocation
5 Monitoring of fund's assets
6 Performance measurement
7 Portfolio construction
8 Risk budgeting
9 Risk Management
10 Overlay
11 Advice on Governance issues
12 Manager selection
13 Integrated Reporting
14 Transition management
15 Custodial / Administration Services
16 Education of Board/Trustees
17 ALM / Modelling
18 Tactical Asset Allocation
19 Dynamic asset allocation

Five conditions for Fiduciary Management

A Fiduciary Management appointment (or mandate) exists when the provider:

1 Is the primary source of strategic investment advice for the fund (or scheme).

2 Monitors and reports on the majority of the fund's (or scheme's) assets relative to liabilities.

3 Is given a degree of delegated discretion to (re-) allocate assets.

4 Has a degree of delegated discretion to make investments (whether directly as fund manager or indirectly by appointing and terminating fund managers).

5 Also has other Fiduciary Management clients, at least one of which is Third Party. 'Third Party' here means that it has no ownership links with that client.

Fiduciary Management - Getting to grips with the finer details

How much of it is there and who provides it?

The Fiduciary Management market in Europe is provided by 29 firms. Between them they manage €761bn in assets on behalf of (at last count) 517 clients.

Most of the 517 client organisations are Defined Benefits Pensions plans, but a few are Defined Contribution. An increasing number are not pensions clients at all, but are other types of institution such as Family Offices and Insurers.

On average each client has assets under Fiduciary Management of €1.5bn, but this figure is influenced by a few very large users and the average varies widely from country to country.

The 29 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 APG and Mn Services.

Between them this small group of Pensions Heritage firms manage €7 in every €10 of Fiduciary assets. But this includes their sizeable In House funds which on their own make up around half of the market. Excluding those funds, and looking only at the half of the market that is made up of third party clients, Pensions Heritage firms manage a rather smaller proportion, as can be seen in the chart to the right.

Asset Management Heritage firms

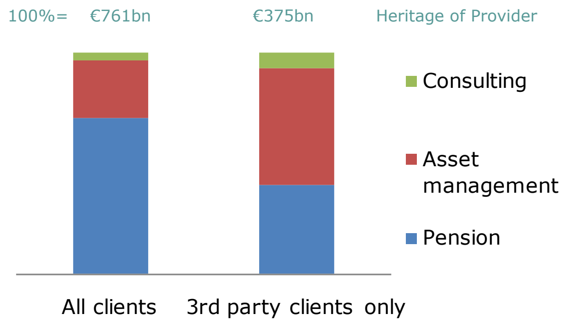
The majority of providers come from an Asset Management Heritage. They offer the range of Fiduciary services as a natural extension of their investment activities. Examples of asset management Fiduciary Managers include Blackrock, Russell Investments and ING. Between them the asset managers manage most of the Third Party assets as can be seen in the chart to the right.

Consulting Heritage firms

The third group, from a consulting heritage, have evolved to provide fiduciary Services from their existing advisory roles with pension plans. Leading firms in this group include Towers Watson and Mercer. 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 as can be seen in the chart.

"Only half of the market is made up of third party clients."

European Fiduciary Management AuM 2010



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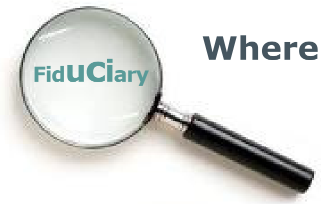


Where does it happen?

The €761bn in Fiduciary Managed assets is predominantly located in the Netherlands. Other countries are starting to grow.

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, represent the remaining 3%.

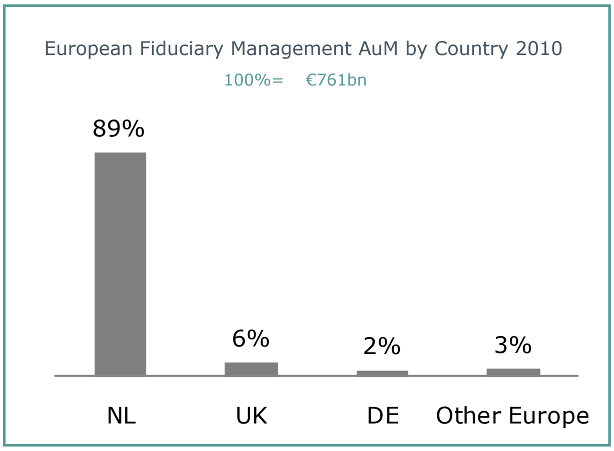
Even after excluding the large In House pools that make up so much of the Netherlands Fiduciary market, the Netherlands still represents 78% of the Third Party assets that we showed were half of the market on the previous page.

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. 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. Of the 29 Providers that we have identified, we believe that half are serving clients in two or more countries.

"Fiduciary Assets total the equivalent of 82% of all Netherlands DB pension assets."



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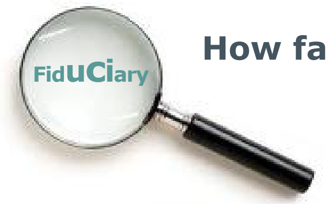


How fast is it growing?

Growth in Fiduciary Management has been particularly noticeable in the past two years.

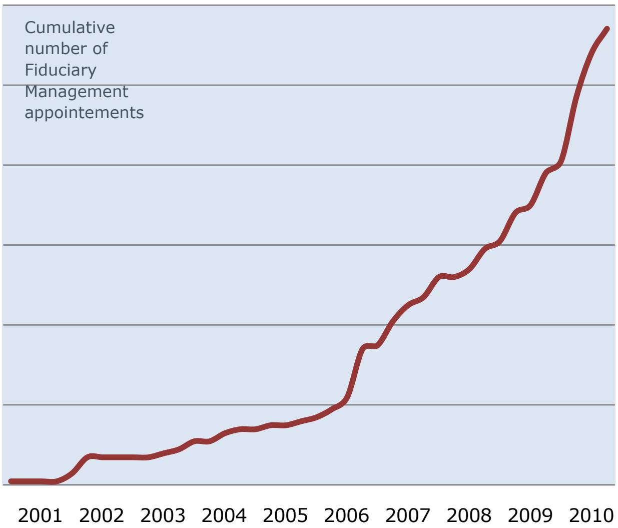
In 2009 we predicted that the financial crisis would give Fiduciary Management "a great opportunity" arguing that schemes will look to form deeper partnerships with providers who are able to supply solutions rather than push products. Since the crisis schemes have tended to focus on "outcome strategies" rather than "possibilities" and focused more on specific funding targets for the scheme.

We argued in 2009 that this new era of demand would offer an ideal opening for Fiduciary Management and all the signs indicate that we were right. The chart on the right 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. In the sample that the chart tracks, half of the appointments over this ten year period have been made in the two years since the end of 2008. 2010 has clearly been a particularly busy year.

Fiduciary Management Appointments 2000-2010

Cumulative number of appointments in a sample of 114 firms that all now use Fiduciary Management



"Half of the appointments have been made in the two years since the end of 2008."

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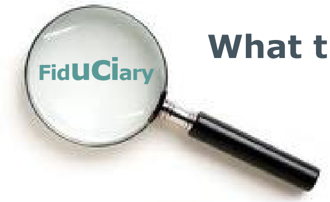

What then are the key issues in this business?

We thought we would leave you with a list of five big questions that it seems to us will shape the growth of the industry in coming years. We have expressed these as short questions. We have some rather more detailed views on each and look forward to discussing these and other issues with you.

"The world will not be the same again for institutional asset managers."

Five big issues in Fiduciary Management

1 **Demand**
The Fiduciary model is still relatively unknown outside the Netherlands and the UK in Europe - is there an appetite for this service across the Continent? Will institutional investors outside DB, such as DC pensions or insurance companies, become new sources of demand for Fiduciary Management?

2 **Consultants**
Consultants have a hold on the UK market like no other - will they be able to force Implemented or Delegated Consulting (their version of the Fiduciary service) to the forefront in coming years at the expense of asset managers? And will consultants be successful in migrating their DB skills into a DC version of Fiduciary Management?

3 **Competition**
Will Fiduciary Management be able to compete with other governance and de-risking solutions that are currently in vogue such as longevity hedging and the buy-in / buy-out market.

4 **Regulatory pressure**
Will regulation play a key role in the growth and evolution of Fiduciary Management in Europe? The Netherlands is seeing growing pressure from their regulator to unbundle risk management from the fiduciary proposition. Will this devalue the fiduciary proposition? Will this create opportunities for specialist risk managers and custodians?

4 **Institutional asset management**
What effect will the trend towards Fiduciary Management have on the institutional landscape? Sophisticated Fiduciary Managers now have delegated authority to manage large pools of institutional assets. In this role, they are demanding higher quality asset management products, and more innovation. But at the same time, their use of external providers is not as high as some asset managers might like. The world will not be the same again for institutional asset managers, but is it a better or worse world than before?

The Broad Brush

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March 11 - Number 8 - Fiduciary Management - Getting to grips with the finer details Everyone has heard of Fiduciary Management. It has grown to become a prominent part of the institutional asset management and consulting business in Europe. And yet ... no one seems entirely clear what it is. We try to clarify.

March 11 - Number 7 - DC pensions - A Fruitful Segmentation of the market Like an orange, the DC market in the UK is both one big thing, and several segments. We have found that the segments are each quite different. Without understanding the differences in the segments, you cannot understand the whole, well, fruit.

Sep 10 - Number 6 - DC pensions - Collective Communications Solving the communications problem in DC Pensions will be helped by a new "collective" model, where members of many schemes are communicated to at the same time. This already happens in other countries, and we predict that it will start to emerge in the UK.

Nov 09 - Number 5 - DC pensions - The gold rush. Few people would associate the UK DC market with a gold rush. Now may be the time for a rethink. We go so far as to suggest that the DC gold rush could throw up a new pool of £600bn in assets.

Aug 09 - Number 4 - European Asset Management - How many futures? Planning has never been so tough. In this new piece we offer some highlights from the "Five Futures" Study that was published recently in partnership with Alpha Financial Markets Consulting. We hope you find it useful.

April 09 - Number 3 - Offshore Distribution - From Backwater to mainstream. As markets start to recover, we think that one of the most attractive opportunities will be catering to upwardly mobile professionals from developing markets via distribution networks in the International Financial Centres. We asked distributors in three of these centres what they wanted from their providers.

Feb 09 - Number 2 - Thought Leadership - A top tool for troubled times . 'Thought Leadership' is an ideal tool for the current climate. It delivers the Sales Team's need for fresh conversation openings in these fast-changing times, and Marketing's need for a low-cost communications channel in an era of vanishing budgets.

Nov 08 - Number 1 - Private Banking - Factories, Homes and Cottages. A new look at the architecture of private banking in Europe As the dust eventually settles on the financial landscape, there will be two businesses less damaged than most: Private Banking and Wealth Management. Existing classifications give little clue to the underlying patterns. We suggest a new Segmentation.

Spence Johnson is a privately-owned specialist provider of marketing intelligence. Its research products and consulting assignments support marketing, sales, and strategic planning in investment based businesses - asset management, life & pensions and wealth management.

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