

While capital markets in the UK have been generally positive over the past two years, a lot of those gains have been offset by increasing liabilities tied to low gilt yields. The 15-year gilt yields, which are typically used to calculate pension scheme liabilities, hit record lows in August 2010. As a result, according to the PPF 7800 index, the aggregate funding status of UK pension schemes went from a surplus of just under £40bn in March 2010 to a deficit of over £40bn by Sept 2010.

Fast forward a few months to February 2011 when gilt yields jumped to their highest levels in eight months, resulting in decreasing pension liabilities. At the same time, asset values remained positive as the FTSE 100 Index entered February maintaining the significant gains that had been realised over the past two years.

This scenario was a positive turn of events for the funding levels of pension schemes, in that strong returns on assets were being realised while, at the same time, liabilities were decreasing. However, in order to successfully take advantage of this type of positive market environment and also protect against negative changes, questions need to be



Changing times

Ashish Kapur asks how a fiduciary manager can help trustees strengthen their pension governance

answered and decisions must be made quickly. Should asset allocation changes be made to lock in some of the asset gains after FTSE crosses 6,000? When should changes to interest rate and inflation hedges be made, if at all? Should the portfolio be re-risked by selling bonds instead of buying them to increase yields and capitalise on high bond prices?

The answer to these questions will vary from one pension scheme to another. For some re-allocating from bonds to alternative asset classes, such as commercial property, may be a useful way of improving long-term returns. For others, a weak sponsor may mean this approach may not be feasible. Either way, it requires trustees or their advisers to be reviewing the funding level and the investment strategy in light of opportunities being offered by markets. Trustee boards that only meet four times a year will not be able to make these decisions in the timely manner in which they need to be made. This means that in most instances, pension schemes are operating within an investment management model that may not provide the ability to manage risk on a regular basis to protect against the downside, nor to capitalise on the opportunities to lock in gains during the good times.

The evolution of fiduciary management continues in the UK for just that reason. As more trustees are looking for greater control of the pension schemes, adopting a fiduciary management model allows trustees to address these two significant issues by constantly monitoring funding levels and then proactively responding to market conditions. The appeal of

this model only continues to grow and in a recent poll, nearly half (44 per cent) of respondents said their organisation was open to including a fiduciary manager in the next selection process.

Assets and liabilities can change dramatically over short periods of time and the journey plan needs to be adapted to address these changes and ensure the scheme stays on track. A governance model such as fiduciary management allows for pension scheme trustees to delegate certain time-sensitive components of investment management to an external expert, thus allowing the trustees to focus on broader strategic issues.

Fiduciary managers are providing services including asset/liability modelling, manager selection, risk management and dynamic asset allocation. The appeal of this approach is that it can further strengthen the overall governance of the pension scheme, benefitting sponsoring organisations and ultimately scheme participants. Partnering with a fiduciary manager ensures the monitoring and management of assets and liabilities on an ongoing basis in an effort to give the pension scheme the best chance of meeting its funding goals.



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