Building a better working world

Does past performance accurately represent the past?

Evaluating the performance of fiduciary managers

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Past performance should only be a small part of the evaluation criteria; greater emphasis should be placed on the fiduciary manager's investment processes, capabilities and their risk management environment.

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The better the question.
The better the answer.
The better the world works.

Evaluating performance

Evaluating the performance of fiduciary managers on a comparable, consistent basis has been notoriously difficult. Notably, the unique characteristics of each scheme's portfolio and the large influence of movements in economic variables such as interest rate and inflation (and any liability hedging) can invalidate comparisons.

The CFA Institute's Global Investment Performance Standards (GIPS®) for Fiduciary Management Providers ("FMPs") addresses this, bringing transparency to the market and allowing performance to be observed on a much more comparable basis. This is fantastic to see in the fiduciary management market, and it would be great to have some of these principles extended to the Investment Consulting market.

EY have reached out to the UK fiduciary management industry to assess how these standards are being interpreted across firms and we outline our observations in this document.

Track record may not be fully representative

The market is concentrated in just a handful of composites

Underperformers can look stronger than outperformers

Composites may be inconsistent with what you are buying

Definition: A composite is a weighted average of one or more actual client portfolios that are managed based on similar objectives and constraints.

Key findings

1. Track records may not cover the majority of client assets...

In some instances, less than 10%[1] of a fiduciary manager's assets under management are included in their track records. The information used to compare performance across fiduciary managers therefore may not be representative of the actual client experience.

To increase confidence within results, you could also confirm with the fiduciary manager if their claim of compliance has been independently verified (this is not currently required under FMPS rules).

There are a wide range of portfolios that fiduciary managers can construct. In many cases, trustees will have chosen to retain some legacy assets, or decided to place more restrictions on their fiduciary manager. Client portfolios with bespoke investment restrictions are not always included in official composites.

Before relying on the data, check to see the percentage of clients it covers to see if it is truly representative.

1 Source: EY, UK Fiduciary Managers

2. The market is concentrated in just a handful of composites...

Table 1: UK Fiduciary Management — aggregate composite data

Composite category		Unconstricted Returns (Liability plus)					Asset Restricted
		Between 0.0% and 0.5%	Between 0.5% and 1.5%	Between 1.5% and 2.5%	Between 2.5% and 3.5%	More than 3.5%	
Hedging	Between 0% and 40%	–	–	–	–	–	8%
	Between 40% and 60%	–	–	–	–	–	
	Between 60% and 80%	–	–	–	3%	–	
	Between 80% and 100%	–	9%	14%	11%	–	
	More than 100%	–	–	–	–	–	
	Unconstrained	–	11%	25%	9%	–	

Based on responses from 16 fiduciary managers.
Composites with less than 2% of the market have been represented by a dash.

There are a large number of composites that can be used within the standards and even the largest providers are unlikely to have clients in all composites.

For the composite data provided, check how many clients are included and don't be overly concerned if a fiduciary manager does not have any clients in a specific composite.

A larger number of underlying clients can provide for a better data set, but can also result in a 'smoothing' effect. This should be considered when comparing results across fiduciary managers.

Analysis shows that the majority of client portfolios are concentrated into, unsurprisingly, composites with target returns between liabilities plus 1.5% p.a. and 3.5% p.a.

For lower and higher return targets, comparable data is still difficult to observe across providers.

Key findings (cont'd)

3. Underperformers can look stronger than outperformers...

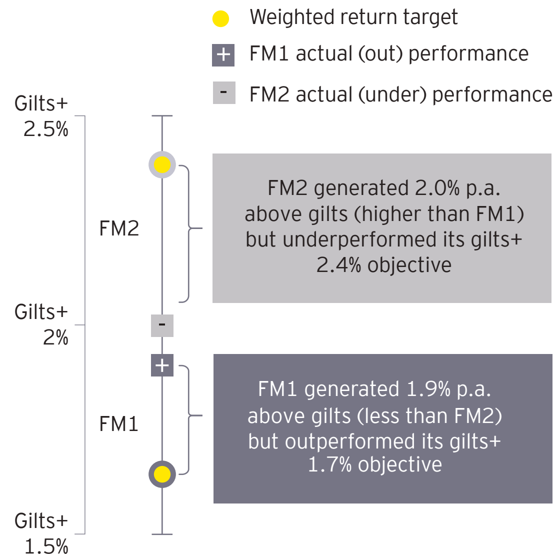
Composites have wide ranging return targets (e.g., 1.5% to 2.5% above liabilities).

If one fiduciary manager is reporting a return of 1.9% above gilts but another is reporting 2.0% above gilts, the latter can be perceived as having stronger performance. Therefore, it is important to consider the average target return to see if this is actually the case. This is particularly important for composites with a low number of clients included.

Both fiduciary managers shown in the example to the right display performance in the 1.5% to 2.5% above liabilities composite. Based purely on the data provided FM2 would look to have performed better than FM1, but once you ask for further detail, we can see that FM2 actually underperformed the weighted return target.

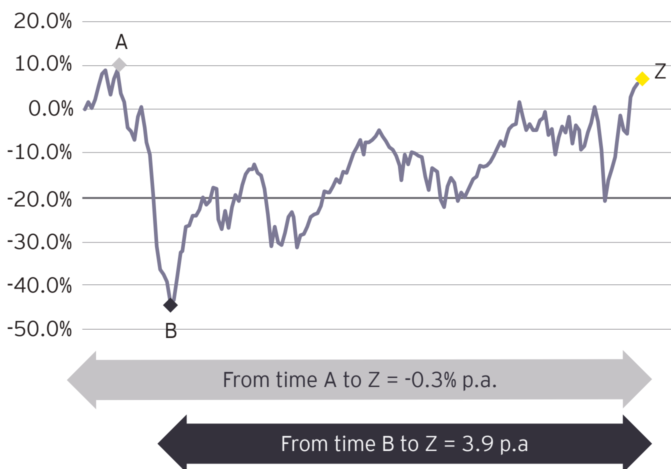
You should therefore ask for the average weighted return target within the composite.

Figure 1: Under-and-out performance



4. Comparisons skewed by inception dates...

Figure 2: Performance over time



The GIPS standards for FMPs specifiy that firms present a minimum of five years of GIPS-compliant history, or since inception if less than five years. This provides some flexibility on the start date for composites which contain more than five years' worth of data.

In our experience, returns tend to be driven by Beta (market) movements and, depending on hedging levels, interest rate and inflation movements. Therefore, it is important that, where possible, performance is considered across consistent time periods.

Performance can look very different over different time periods. To address this the GIPS standards for FMPs requires the provision of data for certain time intervals. It is important that performance is compared across consistent time periods, in the context of prevailing market conditions. This is particularly important when looking at since inception numbers (where some flexibility exists).

Key findings (cont'd)

5. Composites may be inconsistent with what you are buying...

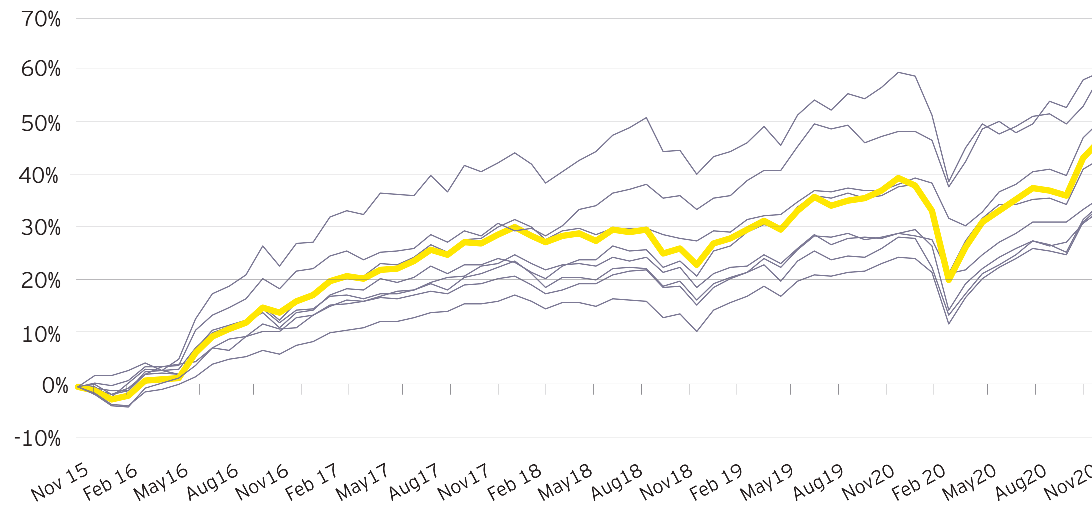
Within a given composite, a single fiduciary manager can have numerous 'best-ideas' portfolios to achieve a certain return target (e.g. some will include a significant allocation to illiquid assets, whereas others may have a low (or no) allocation). Portfolios within a single composite can therefore differ materially.

Check to see if the composite contains assets that are consistent with your beliefs and requirements. In some instances, the composite performance may not be fully representative of what you are looking to purchase.

The inclusion of illiquid assets can result in less volatile performance (depending on the valuation technique used) as the full mark-to-market movement is not realised immediately.

It is therefore important to consider this when comparing across fiduciary managers, especially over any periods of significant liquid market volatility or if you intend to exclude this asset class.

Figure 3: Underlying client performance



The graph shows an example of the performance of individual client portfolios (grey lines) and the actual reported composite return (yellow line). We can see that it is possible to have very different client experience within composites. The GIPS standards for FMPs addresses this with the requirement to provide a dispersion of net returns within composites.

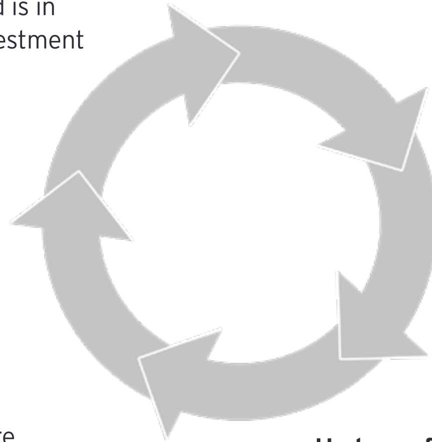
In a nutshell – key considerations

Are track records representative of the majority of clients?

Request the percentage of clients captured within the fiduciary manager's composite performance. Is it truly representative?

Is the data truly representative of your beliefs and requirements?

Request details of the types of underlying assets included to get comfort that the track record is in fact consistent with your investment beliefs and requirements.



Market is concentrated in a handful of composites

Ask for the number of clients in the composite and don't be overly concerned if a track record does not exist.

Are the time periods driving conclusions?

Ensure that any comparisons between fiduciary managers are made using consistent time periods. Market context should be applied to all performance analysis.

Underperformers can look stronger than outperformers

Request the weighted average return target within the composite to truly understand whether a fiduciary manager is under-or-outperforming.

How EY teams can help you

EY teams provide a range of investment governance services, including the evaluation of fiduciary management solutions, and assisting with the selection of fiduciary managers, including breaking down the past performance.

For further information, please visit our website, or contact one of the EY team.

https://www.ey.com/consulting/investment-governance-oversight

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