Not a smooth ride

Ian Morse asks Patrick Groenendijk, CIO of Vervoer about his views on fiduciary management in the light of his fund's experiences with Goldman Sachs Asset Management

Pensioenfonds Vervoer

Pensioenfonds Vervoer, The Netherlands
Assets: €11bn
Location: Groningen, The Netherlands

The Dutch industry-wide pension fund for Dutch transport workers, Vervoer, was an early adopter of fiduciary management. But it is fair to say that its experiences have been mixed.

It hired Goldman Sachs Asset Management (GSAM) as its first fiduciary manager in 2006, then terminated the contract in a well-publicised dispute over the extent and type of portfolio risks and possible conflicts of interest being undertaken by GSAM on its behalf.

Why did Vervoer choose the fiduciary route in the first place? "The main reason is that manager selection is not our core business," says Patrick Groenendijk, the fund's chief investment officer. "The case for fiduciary management is a strong one but much depends on how exactly it is structured."

Performance attribution indicates that 90% of portfolio return is a result of asset allocation; only 10% due to manager selection. "You can easily spend 90% of your time on manager selection and only 10% on asset allocation, unless you subcontract the selection process," says Groenendijk. For Vervoer, the decision to use a fiduciary manager was a result of distinguishing between 'core' and 'non-core' activities.

An interregnum followed the dismissal of GSAM, with Northern Trust, Vervoer's existing custodian, taking over the role of fiduciary manager while a new selection process ran its course. "We ended up with a short list of 10 possible fiduciary managers, of which three could be said to be Dutch," recalls Groenendijk. "In the end, we chose Robeco as best meeting our requirements."

Robeco's Rotterdam HQ may have helped win it the mandate. "Speaking the same language certainly helps," thinks Groenendijk, "but much more important is to have a very good understanding of local tax and regulatory issues." Dutch defined benefit pension funds are among the most highly regulated in the EU, with onerous reporting standard and funding requirements.

"Transparency, so called 'look-through' to underlying portfolio construction and risk exposure are very important here," he adds, "We needed a local manager that can achieve and sustain these standards." The fiduciary manager must also understand the pension schemes assets and liabilities, even if it has no responsibilities on the liability side.

The overall design of Vervoer's fiduciary management structure is intended to optimise its control. There are currently 25 underlying managers running segregated portfolios but each asset manager is contracted directly with Vervoer. "When we terminated Goldmans this was just an operational conversion to Northern Trust," recalls Groenendijk. "We did not have to sell out portfolios and incur transaction costs as a result, nor did we need to negotiate with Goldman after termination."

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Other important factors in the selection process hinge on how the fiduciary manager sees its role. Manager style can be an important variable in determining returns and in portfolio construction. "We do not think that a fiduciary manager doing manager selection should have their own views and preferences on style because this can create a sub-optimal style bias in the portfolio."

Measuring and comparing fiduciary managers is a problem: as it provides client-specific solutions and fiduciary management is relatively new, performance measurement is a problem. Vervoer constructs its benchmark from the beta of the asset classes within the strategic asset allocation. Approximately two-thirds of the assets are in fixed income securities, the balance diversified between equities, real estate, private equity and other asset classes. The fiduciary manager is given a risk budget, expressed as a tolerance for 2% tracking error from the benchmark, and can then take bets on manager and style selection to create alpha.

Many fiduciary managers and consultants express a preference for performance-related fees. This is not Vervoer's preferred solution. "We use fixed fees with our fiduciary manager. This is expressed as a basis point percentage of portfolio asset value combined with a fixed cash fee." This is transparent and less open to disagreement than performance related fees: "Performance hurdles and the like are always open to manipulation," adds Groenendijk. "I am not sure that they reward consistency, which is a quality we want to see in our fiduciary manager."

After making the manager selection decisions, the fiduciary manager is expected to secure reductions in the annual management fees charged by the selected managers: "When we selected our fiduciary manager their power to get fee discounts was also important. This is an economy of scale and it should offset some or all of the fiduciary manager's fees and charges."

The role of custodian is vital in this arrangement. "We give control to the chief investment officer and pension board both at an operational as well as a strategic asset allocation level," comments Wim van Ooijen, country head for Northern Trust in the Netherlands. As custodian, Northern Trust provides custody services directly to each of the segregated mandates run by the 25 managers selected by Robeco. "In addition through Northern Trust Global Advisers, we optimise the clients insight into asset interpretation and risk, not just at a mandate level but also at an aggregated level where strategic decision taking remains in the hands of the pension board rather than the fiduciary manager."

The version of fiduciary management favoured by Vervoer is not the only one in the market. Smaller pension funds, in particular, have chosen to delegate much wider powers to their fiduciary managers than large ones like Vervoer. "There need to be checks and balances around fiduciary management," cautions van Ooijen, "I think that there may be a trend to less outsourcing than in the past also by the smaller to mid-sized pension schemes." The Dutch pension regulator has made it clear that pension boards must retain direct responsibility for strategic asset allocation and asset/liability modelling. "Clients are now taking much more care in the way they establish their governance model so the pension board or trustees stay in continuous control," van Ooijen adds. To this end, custodians are being asked to report a wider set of data directly to the board with an emphasis on risk and performance attribution.

"Fiduciary management is not defined legally in Europe as it is in the US," cautions Jeroen Wilbrink, investment principal at Mercer Consulting in the Netherland. This means that fiduciary management can describe a far wider range of relationships between client and manager.

Concern over this by the Dutch pension regulator has caused it to remind pension boards of their responsibilities and liabilities, and to point out the limits of delegation.

"Some early adopters in the Dutch market delegated more powers than the regulator now regards as optimal," Wilbrink adds. "We are seeing de-delegation, a partial reversal of this trend with pension boards looking to take back direct oversight and involvement in key areas such as asset liability modelling."

This of course, is where third party pension consultants like Mercer are finding new business. "Much depends on the size of a pension fund," adds Wilbrink. "Some can afford a large in-house pension bureau, others need our help because they lack the internal resources for this."

Once the fund's strategic benchmark is set up, consultants may also offer to implement this strategy as advisory fiduciary managers or delegated consultants. Another factor is that some of the largest Dutch pension funds, namely ABP, PGGM and the metal industry funds, have spun out their own asset management operations and now offer third party fiduciary management.