

A nighttime aerial view of a city, likely Hong Kong, featuring several illuminated skyscrapers and a complex highway interchange with light trails from traffic. A large yellow rectangular box is overlaid on the left side of the image, containing the title and date.

2017 Fiduciary management fees survey

February 2018

The EY logo, consisting of the letters 'EY' in a bold, white, sans-serif font. A yellow diagonal line is positioned above the 'Y'.

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Survey highlights

Larger range of fiduciary management fees

The spread of fiduciary management fees continues to rise, reflecting an increasing ability of the industry to provide solutions in line with different clients' needs. A number of providers are now offering a range of solutions that vary in areas such as levels of active versus passive management, the allocations to alternative asset classes, and approaches to changing the asset allocation over time. This has had a direct impact on the level and structure of fees we have seen in our survey.

Range of investment management fees

The fee differentials for investment management fees are surprisingly wide, even for asset classes such as passively managed equities, which suggests there are different abilities of fiduciary managers to negotiate fee discounts with underlying managers. Additionally, it means that trustees and sponsors need to look at all components of fees when assessing overall value for money for a fiduciary management mandate.

Relationship between fiduciary management fees and total costs

The relationship between fiduciary management fees and total costs is not so clear cut. Fiduciary management fees can range from between 11% to 70% of total costs, further validating the need to consider total costs when comparing fees and costs, as a low fiduciary management fee in itself does not give any indication of total costs.

Introduction

Better cost transparency aids assessment of value

Over time, we have seen an improvement in the transparency of fees and costs, and this survey aims to add more light to help trustees and sponsors assess whether their fiduciary management arrangements provide value for money.

With more demand for fiduciary management services, there continues to be evolution in the fiduciary managers' offerings, which also impact the total costs. In addition to fiduciary management and investment management fees, we also asked the fiduciary managers to provide details of expenses that would be incurred; we believe it is important to understand total investment costs.

There is a lot of differentiation between the offerings of different fiduciary managers in terms of services provided, the underlying investment beliefs and philosophies, and the portfolio construction process, to name a few. In order to create some comparisons, for the purpose of our survey we gave the fiduciary managers a scenario, for four hypothetical pension schemes with specific return targets, and left all remaining decisions (e.g., level of hedging and asset allocation) up to the fiduciary managers.

Survey respondents

The information in this survey is based on responses received from 15 fiduciary managers who collectively manage the majority of assets in the UK fiduciary management industry (listed below). Of these 15 fiduciary managers, three provided two fiduciary solutions, and therefore the survey is based on 18 different solutions. We would like to extend our gratitude to these firms for their participation.

Aon Hewitt	Cardano	JLT	Mercer	Schroders
BlackRock	Charles Stanley	Kempen	P-Solve	SEI
Cambridge Associates	Goldman Sachs Asset Management	LGIM	Russell Investments	Willis Towers Watson

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Introduction (cont'd)

Hypothetical pension schemes

There are a number of providers of fiduciary management services, whose solutions can also differ depending on scheme size and objectives. In order to obtain comparable results across the providers, and for consistency with previous surveys, we based this survey on four hypothetical pension schemes:

- ▶ Small - £50m
- ▶ Medium - £250m
- ▶ Large - £750m
- ▶ Very large - £1.5bn

In all cases, the trustees require the full range of advisory, implementation and communication services (as described on the previous page) from their fiduciary manager:

In our previous surveys, we had specified an initial asset mix, and asked fiduciary managers to set out their fees assuming the asset allocation does not change. Increasingly, fiduciary managers have the freedom to allocate assets in line with their best ideas, provided they expect to generate the required return and operates in line with the pension scheme's journey plan.

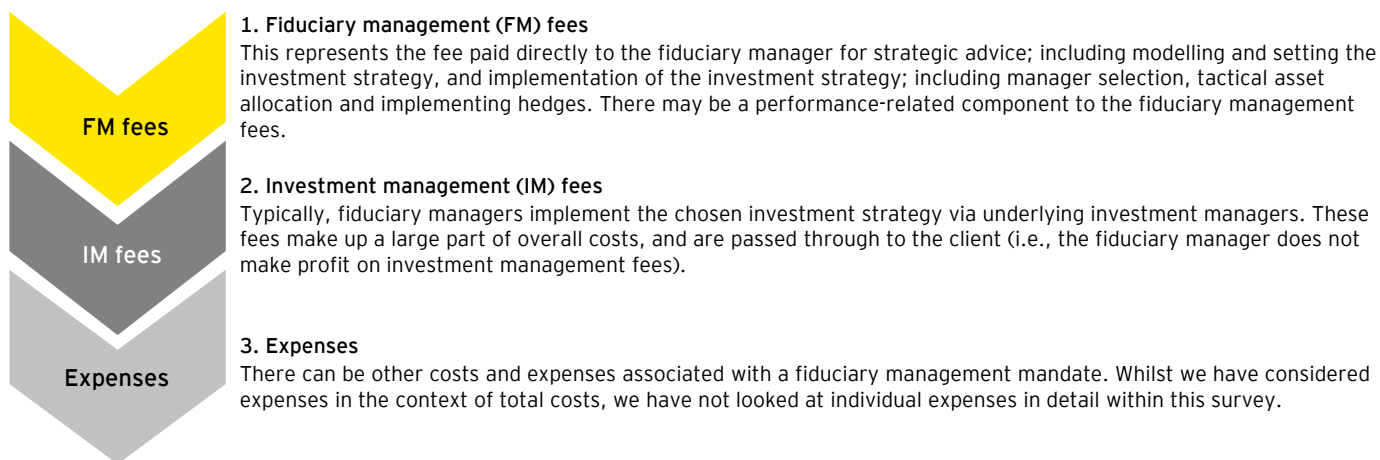
Therefore, in this year's survey, we specified the following characteristics for all four sample schemes:

- ▶ A liability duration of 20 years, with a 50:50 split between nominal and inflation-linked liabilities
- ▶ A target return of liabilities +2.5% pa

Components of fees in a fiduciary management (FM) mandate

Components of fees

The fees in a fiduciary management mandate can be separated into three components:



Typical services in an FM mandate

Fiduciary management is a service, and the fees reflect the level of services provided. In our experience, many schemes will have different service needs and requirements, and therefore the fees do differ from client to client within the same fiduciary manager. For instance, one pension scheme may define the asset allocation and delegate the decision to hire and fire investment managers, whereas another could also delegate the asset allocation decision (giving the fiduciary manager further freedom over the portfolio), which would have a higher fee associated with it.

The following table shows the typical services which are commonly covered in a fiduciary mandate:

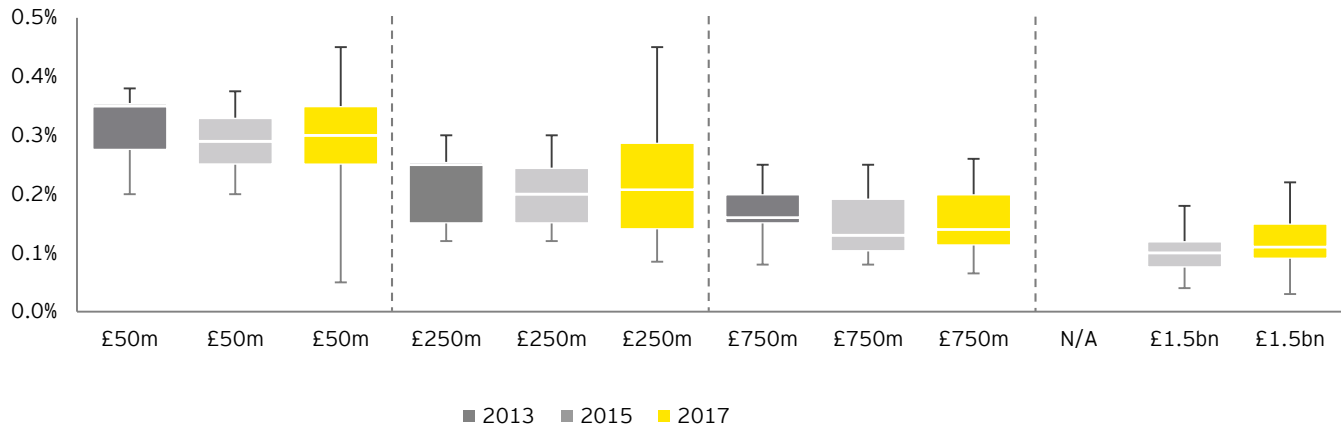
Advisory services (FM advises trustees who ultimately make decision)	Implementation services (trustees have delegated authority to the FM to take actions on their behalf)	Communication services
Design of a de-risking journey plan	Implementation of investment strategy (including liability hedging)	Meetings
Regular recalibration of strategy	Execution of journey plan de-risking	Performance and risk reporting
	Dynamic/tactical asset allocation	Trustee training
	Selection/replacement of underlying investment managers	

Fiduciary management fees

Fiduciary management fees have typically been charged as a percentage of assets basis, however there are variations of fee structures available, including fixed nominal fees, which may increase annually in line with an index, such as inflation. For comparison purposes, we have shown fees as a percentage of assets within the results of our surveys.

How have fiduciary management fees changed since 2013?

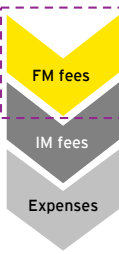
Figure 1: Distribution of fiduciary management fees in 2013, 2015 and 2017



EY Insight:

As in our previous surveys, the 2017 results show that fees reduce as scheme assets under management increase. This is a natural outcome of the cost of advisory services, which do not vary materially with size of assets, being spread over a larger asset base.

There is a wider range of fees across all scheme sizes than in previous surveys, although the inter-quartile range has remained broadly consistent. This is largely the outcome of an increase in the number of solutions and providers in the market, designed to meet different clients' needs; the fees are not dependent on the size of a scheme alone, but also the investment solution.



Fiduciary management fee structures

The structure of fees is coming into increasing scrutiny; transparency of fiduciary managers' fees is more important to clients than ever before.

Bundling of fees

The typical fiduciary management fee structure separates FM fees from the fees of underlying investment managers. This means that any changes to underlying manager fees, including savings negotiated by the fiduciary manager, pass through to clients.

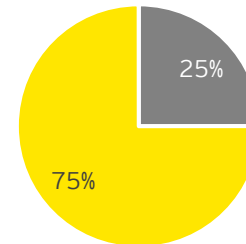
A few providers offer a bundled fee structure whereby a client would pay a single fee covering both fees to the fiduciary manager and underlying investment managers.

Performance-related fees

There are divided opinions on compensation of fiduciary managers based on performance. A number of fiduciary managers are willing to offer performance-related fee structures, and our survey shows that around a quarter of schemes that have appointed a fiduciary manager have a performance-related fee structure in place.

There is, however, variation in the details, including the benchmark over which a performance is paid, and the quantum of the performance fee itself. The range of the "fee at risk" under a performance fee structure varies from around 10% to 65%.

Figure 2 - % of schemes with performance-related fees for their fiduciary manager



- % of clients with performance-related fees
- % of clients without performance-related fees

EY Insight:

Bundled fee structures are more likely to raise questions about conflicts of interest; the incentive of a fiduciary manager can move from finding the best investment manager to the cheapest investment manager. Alternatively, any investment manager fee savings negotiated may not pass through to clients.

A performance fee can create volatility of fees. Proponents of performance argue that such fees would align the interests of investors with those of clients; the extent to which is true is down to the details of the construction of the overall fee.

Fee structures can have a material impact on incentives and it is important to understand these and ensure alignment of interests between the fiduciary manager and the trustees.



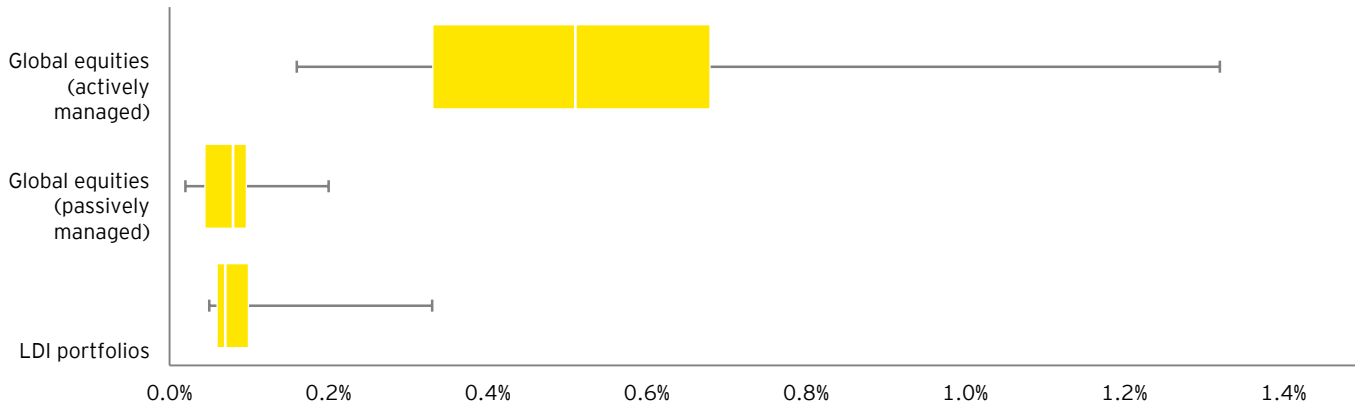
Investment management fees

Investment management fees

The absolute level of fees is a function of the asset classes that are invested in, and the ability of a fiduciary manager to negotiate fees with underlying investment managers. To a large extent, the underlying investment manager fees are the same for all clients of a fiduciary manager. This is consistent with the rationale that a fiduciary manager should be able to use its scale to negotiate underlying investment manager fees across its entire client base.

However, our survey results show there is a wide range of underlying investment management fees. For some asset classes, such as actively managed equities, there can be heterogeneity in investment managers' approaches resulting in a variation of fees however, the dispersion of fees for passively managed equities, which would be expected to be more homogeneous, is surprising.

Figure 3 - Distribution of investment management fees for equities and LDI for a £250m scheme



EY Insight:

The wide range of underlying investment management fees emphasises the importance to consider all elements of fees when considering a fiduciary management mandate. The differential in investment management fees between providers can make a significant impact on a pension scheme's outcomes.



Total fees

Fiduciary management fees plus investment management fees

Our view is that it is important to consider the total costs when evaluating a fiduciary management fee proposal. This year's survey shows that the total of fiduciary management and investment management fees has continued to fall as the industry has grown, although we recognise there is a change in the methodology for the 2017 survey.

Figure 4 - Median of fiduciary management fees plus investment management fees

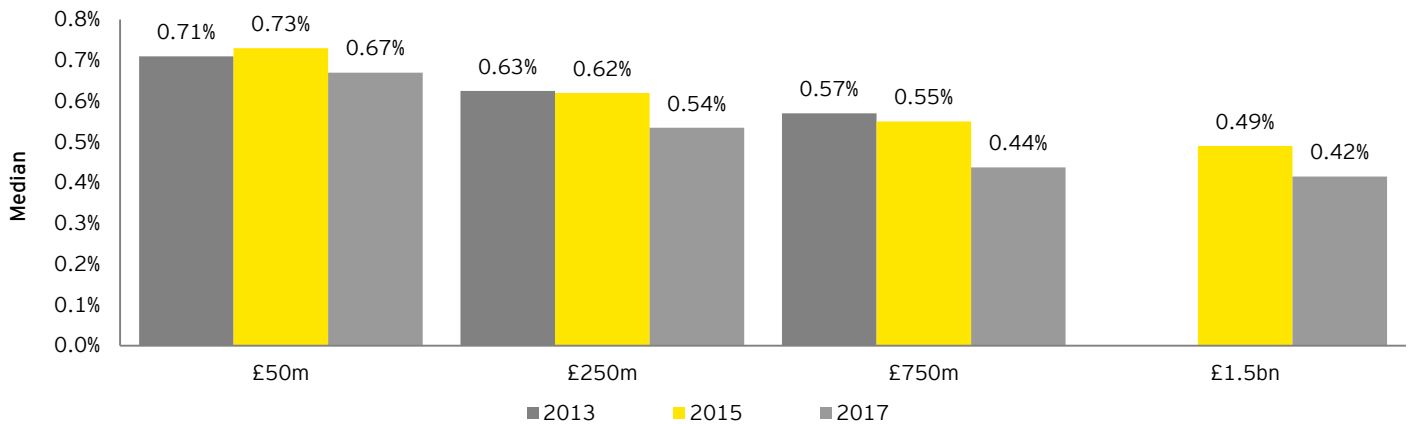
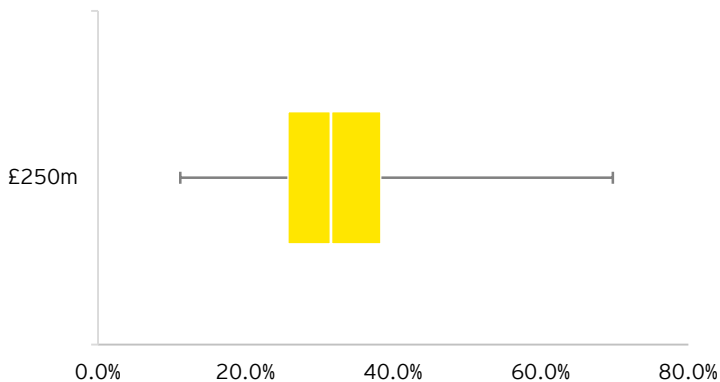


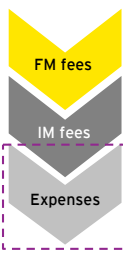
Figure 5 - FM fees as a proportion of total costs for a £250m scheme



EY Insight:

A lower fiduciary management fee can be perceived to represent "better" value for money. As can be seen from the chart on the left, the proportion of total costs represented by the fiduciary management fee ranges from around 11% to 70%, so trustees may not appreciate more material costs if the focus is on fiduciary management fees alone.

It is important therefore to consider value from a range of different perspectives before concluding whether a given fee structure is attractive or not.



Expenses

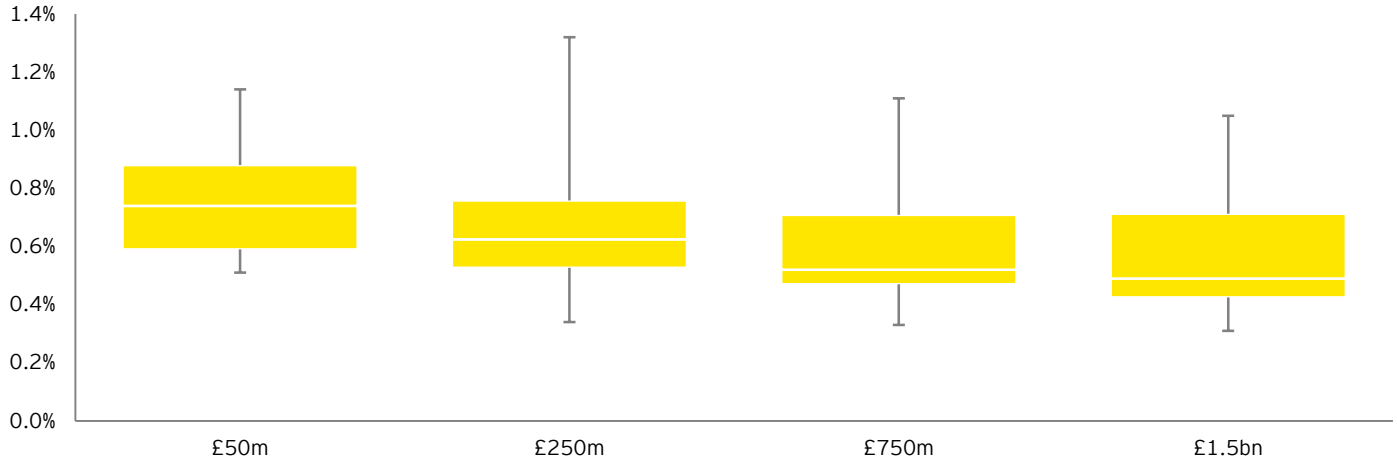
The final component of costs within an investment mandate is expenses; expenses incurred by the fiduciary manager, as well as expenses incurred by the underlying investment managers are all ultimately paid by the investor.

Expenses are often overlooked when evaluating providers' fee arrangements, sometimes due to less transparency, but often simply ignored. We believe investors should look at total costs, and hence aim to identify all fees and expenses which would be incurred as part of the mandate. There are various explicit and implicit expenses which ought to be considered as part of this total fee, including:

- ▶ Custody fees
- ▶ Administration fees
- ▶ Performance measurement fees
- ▶ Fees for legal reviews of documentation
- ▶ Fiduciary manager pooled fund expenses
- ▶ Investment manager pooled fund expenses
- ▶ Transition management fees

The chart below shows the distribution of the sum of fiduciary management fees, investment management fees and expenses.

Figure 6 - Distribution of total fees including expenses



EY Insight:

This year's survey shows that schemes could incur as much as 0.2% pa in expenses in addition to FM and IM fees. Expenses can create a non-trivial drag on returns, and therefore should be considered as part of the evaluation of a fee proposal.

How EY can help you

This survey focuses on the fees and expenses for a fiduciary management mandate, which we believe can provide useful benchmarking for trustees and sponsors considering fiduciary management. However, it is important for pension schemes to assess the fees and costs in relation to the value that a fiduciary management mandate can offer their own scheme, particularly around management of investment and operational risks, and the resulting impact on risk and return.

EY provides a wide range of investment governance services, including evaluation of Schemes' current governance structures, and assisting with the selection and oversight of fiduciary managers.

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

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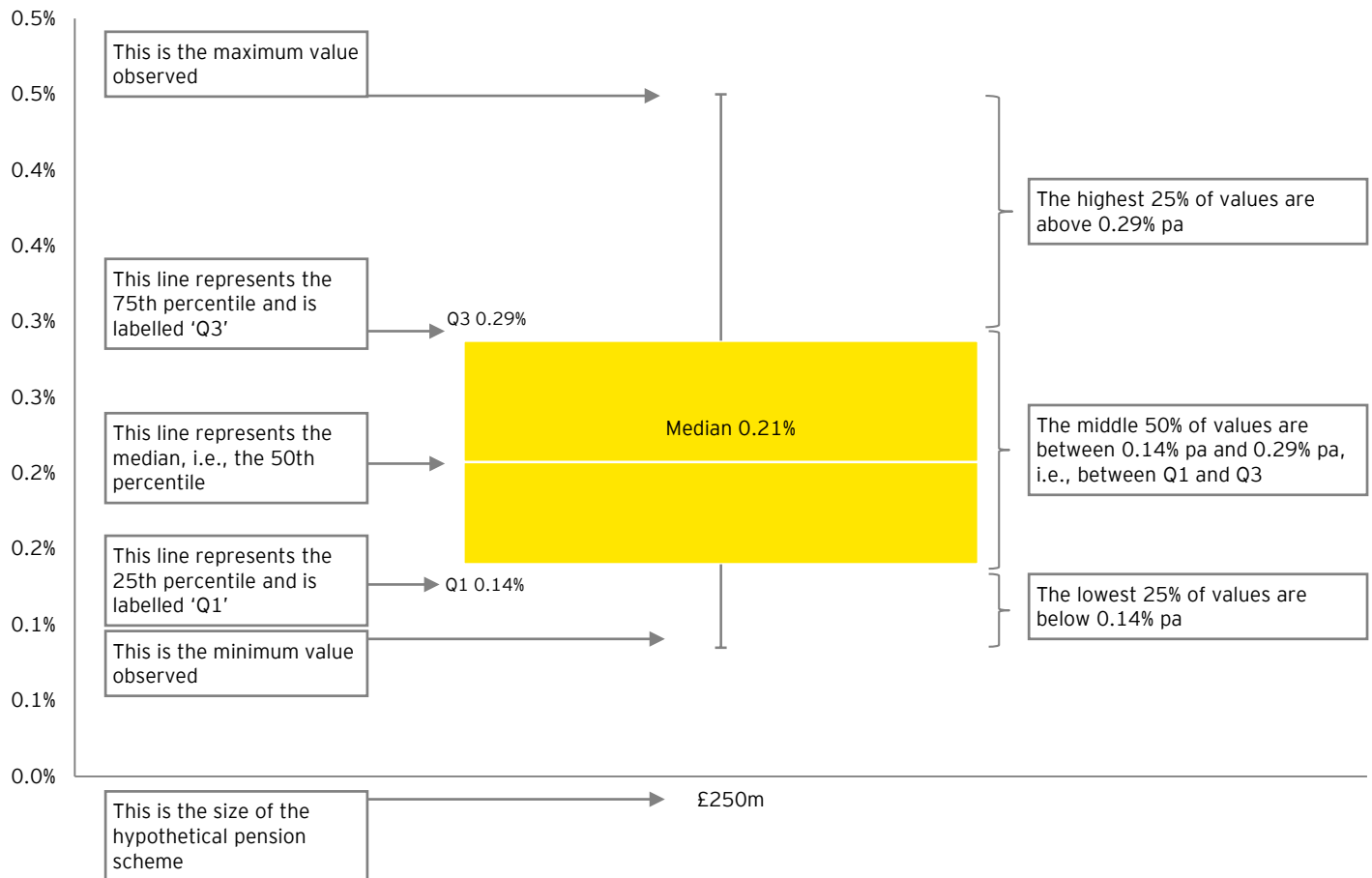
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Appendix: How to read a box plot

We have used several box plots throughout this document to illustrate the spread of survey responses. In particular, the box plots show at a glance the range of the middle 50% of responses. The example below explains how to interpret the graphs.

Example - Fiduciary management fees



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EYG no. 00611-184Gbl

EY-000054472-01 (UK) 02/18. CSG London.



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