2021 Fiduciary management fees survey

5th edition

July 2021

EY Parthenon
Building a better working world

Contents

Survey highlights

Competitive market pressure

Comparing to 2019, the median level of fiduciary management (FM) fees has fallen by over 10% across all scheme sizes. FM fees have, on average, fallen by 20%–30% since 2013.

There is a wide range of management fees proposed across all scheme sizes, reflecting the variation in the underlying portfolios and investment beliefs. However, with growing scrutiny on disclosure and transparency of costs, as well as the competitive tender process introduced by CMA, we continue to see a fall in median fees (fiduciary management fees plus investment management fees) across schemes of all sizes.

Maturing pension schemes

Total fees (including expenses) fall by around 20% when schemes lower their target investment return from liability +2.5% pa to liability +1.5% pa. Surprisingly, despite schemes moving to a lower risk solution, our survey shows this is not reflected in the FM fee arrangements – the total fee reduction comes from lower investment management fees for schemes with lower return targets.

As funding levels improve, it is natural to reduce investment risk and target a lower investment return along the flight path. An increasing number of providers are offering solutions for such schemes, focusing on cashflow matching.

Benefits of scale

Most fiduciary managers have negotiated underlying investment managers by at least 10 bps. These fee reductions, on average, can offset 60% of the FM fees charged for a medium-size scheme (GB£250m).

Fiduciary managers are able to use their scale to negotiate underlying investment manager fees across its entire client base.

Ongoing transaction costs

We noticed that there are large variations in the overall ongoing transaction costs disclosed by fiduciary managers. Trustees should be aware that the MiFID guidelines can be interpreted differently, therefore the costs for the same funds can be reported differently, making comparisons less meaningful. Without an in-depth understanding of portfolio content and structure, decisions can be made based on data that is not comparable.

The investment industry has been under greater scrutiny in recent years, with providers being required to provide better detail on fees and costs incurred. Fiduciary managers now need to provide cost disclosures in line with MiFID II. Ongoing transaction costs are not directly charged to the investors, but do have an impact on the returns achieved.

Introduction

EY teams have been conducting fiduciary management fees survey since 2013. In the past few years, 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.

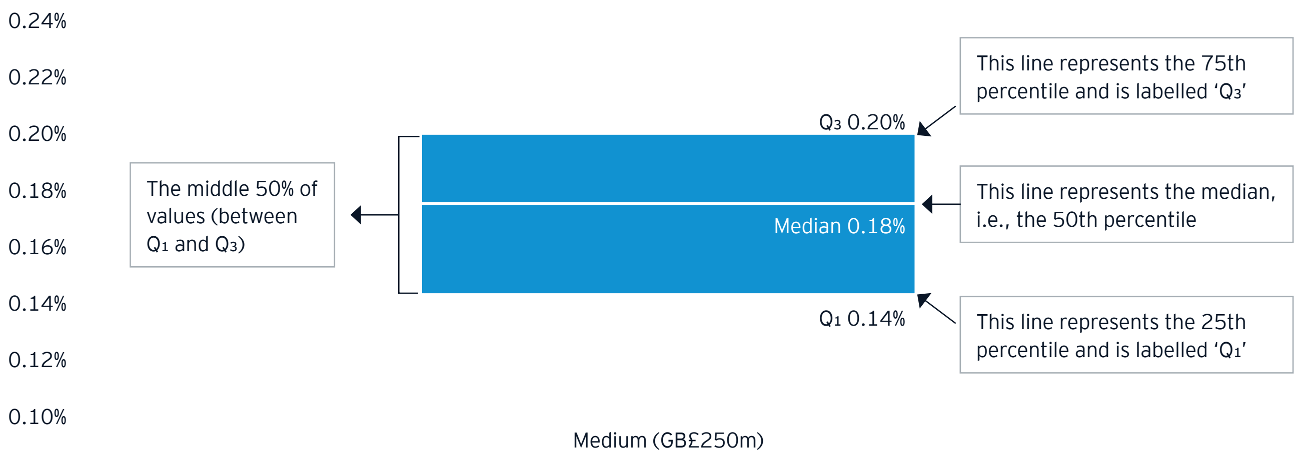
With more demand for fiduciary management services, there continues to be an evolution in the fiduciary managers' offerings, which also impact the total costs. Consistent with our previous surveys, this survey explores details of total investment costs, including fiduciary management fees, investment management fees and expenses that would be incurred. In addition, following the introduction of MiFID II reporting requirements, we have also included details of ongoing transaction costs in this survey to promote better transparency of fees in the industry.

> "Our purpose is to strive to improve transparency from fiduciary managers and educating trustees. Without an in-depth understanding of the differences behind the costs, decisions can be made based on inconsistent information.

How to read our analysis

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 inter-quartile range (the middle 50% of values) of responses. The example below explains how to interpret the graphs.

Example – Fiduciary management fees (2021)



Using this survey

Where the information in this survey is reproduced, either in numerical or chart form, EY teams and EY *"2021 Fiduciary management fees survey"* should be disclosed as the source of the material.

Services provided by fiduciary managers

Fiduciary management typically covers the full range of investment services that a pension fund needs. This includes provision of advice on the investment strategy, implementation of the investment strategy and reporting of performance. As pension schemes' funding levels improve and they get closer to their end-game, the nature of fiduciary managers' offerings are expanding to cover advice on settlement solutions, and managing run-off portfolios. The fee arrangement that each Scheme has with their fiduciary manager, therefore, needs to take account of the Trustees' specific requirements including any constraints on the portfolio.

There is a lot of variety across different fiduciary managers offerings 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 18 fiduciary managers who collectively manage the majority of assets in the UK DB fiduciary management industry. Of these 18 fiduciary managers, seven provided two fiduciary solutions and one provided three fiduciary solutions. Therefore the survey is based on 27 different UK solutions. We would like to extend our gratitude to the fiduciary management industry for their participation.

Hypothetical DB 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 the following hypothetical DB pension schemes:

UK DB schemes:

- Small – GB£50m
- Medium – GB£250m
- Large – GB£750m
- Very large – GB£1.5b

In all cases, the trustees require the fiduciary manager to manage 100% of their assets and the full range of advisory, implementation and communication services (as described on the previous page) provided by their fiduciary manager.

As per our previous surveys, we had specified the following characteristics for all 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

As pension schemes' funding levels improve, there is an increasing number of schemes that are de-risking. This year we have also included information on sample schemes with a lower return target:

- A target return of liabilities +1.5% pa

Components of fees in a fiduciary management (FM) mandate for DB pension schemes

Components of fees

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

Fiduciary management (FM) fees

This represents the fee paid directly to the fiduciary manager for strategic advice (including modelling and setting the investment strategy) and implementation of the investment strategy (including manager selection, tactical asset allocation and implementing hedges). There may be a performance-related component to the fiduciary management fees.

Investment management (IM) fees

Typically, fiduciary managers implement the chosen investment strategy via underlying investment managers. These fees make up a large part of overall costs, and are passed through to the client.

Expenses

There can be other costs and expenses associated with a fiduciary management mandate. Such expenses are not included in the FM fees or IM fees. We have considered expenses in the context of total costs, and in isolation (please refer to page 7 for further details).

Ongoing transaction costs

There are ongoing costs incurred when trading underlying securities within the portfolio (both explicitly and implicitly). Ongoing transaction costs are not directly charged to the investors (hence not captured in the total costs mentioned above), but they do have an impact on the returns achieved. Fiduciary managers are required to provide cost disclosures in line with MiFID II.

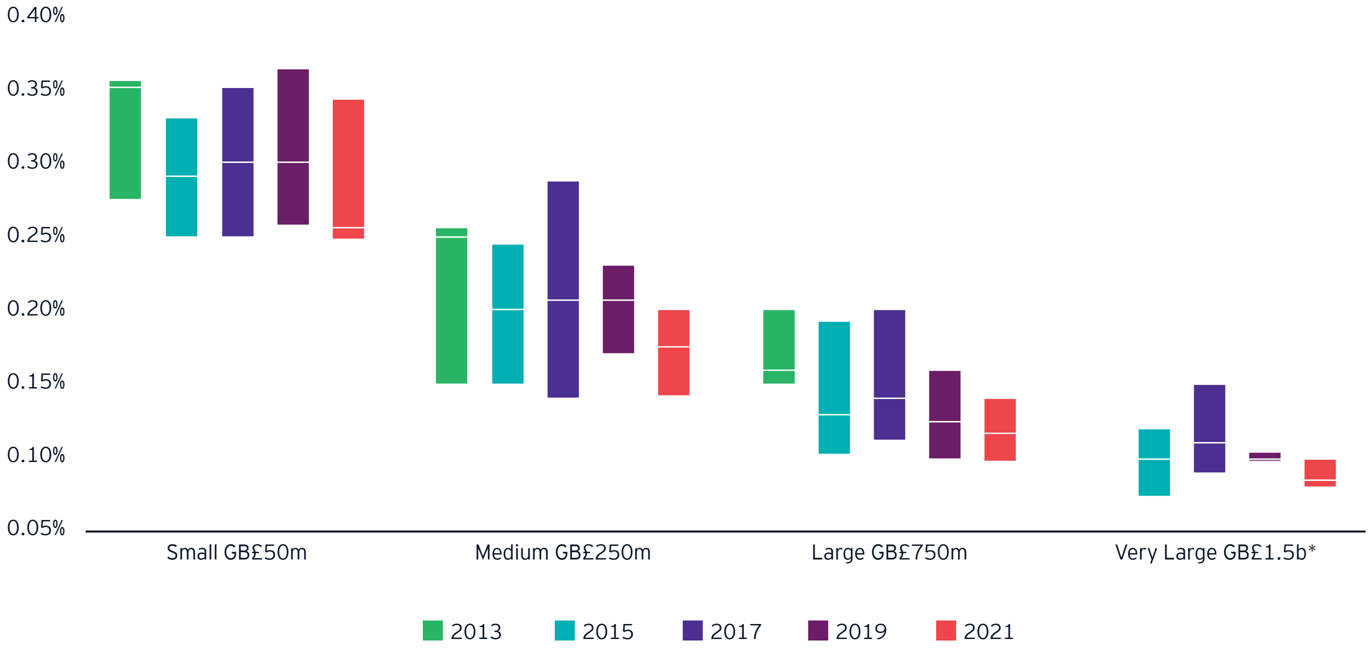
FM fees

FM fees → IM fees → Expenses → Ongoing transaction costs

Fiduciary management fees have typically been charged as a percentage of assets, however there are variations of fee structures available. It is common to see fixed nominal fees, which may increase annually in line with an index (such as inflation), as well as fees charged as a percentage of the asset value. For comparison purposes, in this survey, we have shown fees as a percentage of the asset value.

How have fiduciary management fees for UK DB pension schemes changed since 2013?

Figure 1: Fiduciary management fees since 2013



*Note: 2013 FM fees of very Large GB£1.5b schemes are not shown due to limited number of responses

EY Insight:

As in our previous surveys, the 2021 results show a reduction in FM fees (as the percentage of assets) as the asset value increases. The median annual FM fees fall from 0.26% to 0.09% as scheme size increases from GB£50m to GB£1.5b. This is a natural outcome as the cost of advisory services do not vary significantly with size of assets, and that cost is spread across a larger asset size.

There remains a downward trend on FM fees for all scheme sizes. **Comparing to the 2019 survey, the median level of FM fees has fallen by over 10% across all scheme sizes (and by 20%–30% since 2013**). This has been driven by the growing scrutiny on disclosure and transparency of costs, as well as more competition in the industry.

As increasing number of pension schemes are getting closer to maturity, many are starting to de-risk their portfolios, reducing their return targets. **Surprisingly, our 2021 survey shows that, the FM fees are very similar for schemes targeting Gilt+2.5% and Gilts+1.5% across all scheme sizes.**

Reviewing the FM fees periodically can help trustees to ensure the level of fees payable are in line with the details of the mandate, and ensuring overall value for money from their fiduciary management services.

Fiduciary management fees plus investment management fees

It is important to consider the total costs when evaluating a fiduciary management fee proposal. As per our previous surveys, the 2021 survey shows that total fiduciary management and investment management fees have continued to fall for most scheme sizes.

Figure 2: Fiduciary management fees plus investment management fees (excluding expenses)

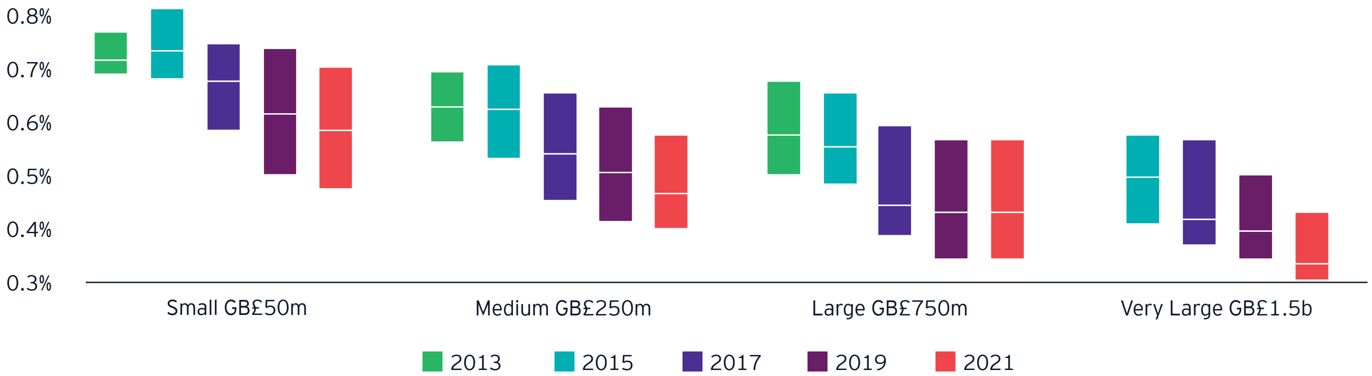
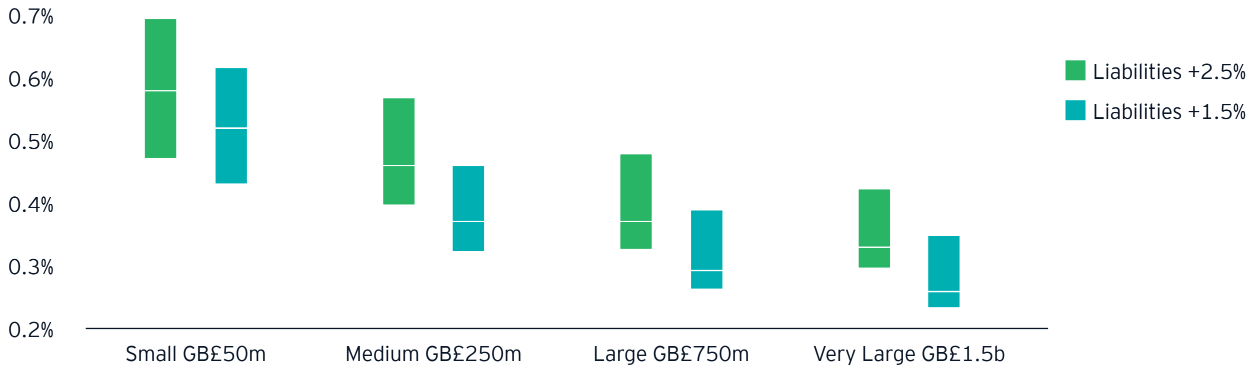


Figure 3: FM+IM fees for schemes targeting liabilities+2.5% p.a. and liabilities+1.5% p.a. return



EY Insight:

Fiduciary managers have different abilities to negotiate fee discounts with underlying managers, based on economy of scale. These savings are largely passed directly to clients.

Our survey shows that most fiduciary managers have negotiated underlying investment managers by at least 0.1% p.a. In some cases, these fees reductions can be higher than the fees charged from the fiduciary management service itself.

EY Insight:

There is a fall of around 25% in total fees (excluding expenses) across all scheme sizes as schemes reduce target return from liabilities + 2.5% p.a. to liabilities +1.5% p.a. This is due to the lower investment management fees in portfolios with lower allocations to return-seeking assets.

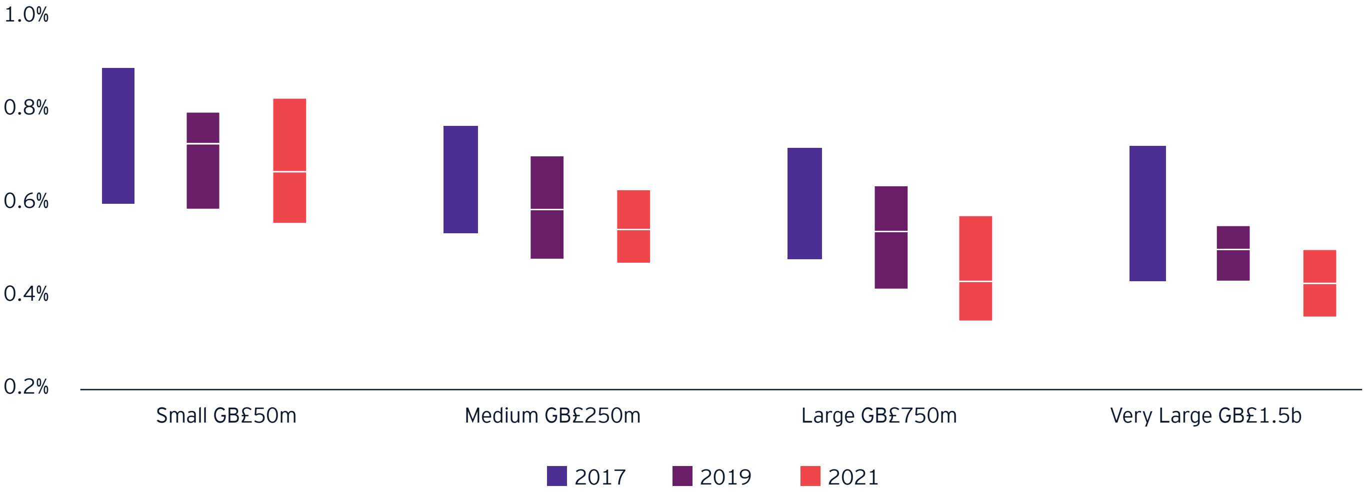
Therefore, It is important for trustees to consider the construction of the portfolio, as well as the structure of the investment portfolio when assessing total fees.

Total costs (FM fees, IM fees and 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.

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, and ultimately detract from net investment returns.

Figure 4: Total fees including expenses for UK DB fiduciary management services



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

EY Insight:

Since our previous surveys, we have seen a fall in the median level of total fees (including expenses) across all scheme sizes.

Expenses are a non-trivial drag on returns; they can constitute over 30% of the total costs. It is critical that these are considered a key part of the fee proposal evaluation process.

Our survey shows that expenses are very similar for schemes targeting liabilities+2.5% p.a. and liabilites+1.5% p.a. across all scheme sizes.

Ongoing transaction costs

Following recent regulation changes, FMs are required to provide cost disclosures complying with the MiFID requirements. Transaction costs are incurred through trading of underlying securities.

Although these ongoing transaction costs are not invoiced to pension schemes, they are an important element to consider as they do impact the overall returns of the portfolio. The cost estimates depend upon a range of factors:

1. Investment strategy and asset allocation

Similar to investment management fees, transaction costs depend heavily on the underlying asset allocation of the portfolio, with alternative assets having higher transaction costs due to higher turnover and operational activities; and less for more liquid assets, e.g., investment grade credit.

When comparing transaction costs of different fiduciary managers, it is important to assess the costs relative to the construction of the portfolio.

2. Management style

Ongoing transaction costs also depend on whether the underlying investments are actively or passively managed, frequency of trading and the turnover of the underlying funds. More actively managed funds have higher ongoing transaction costs.

Our survey shows the median of passive developed market equity funds is much lower than for active funds. However, it is interesting to note some actively managed funds can incur lower ongoing transaction costs than passive funds.

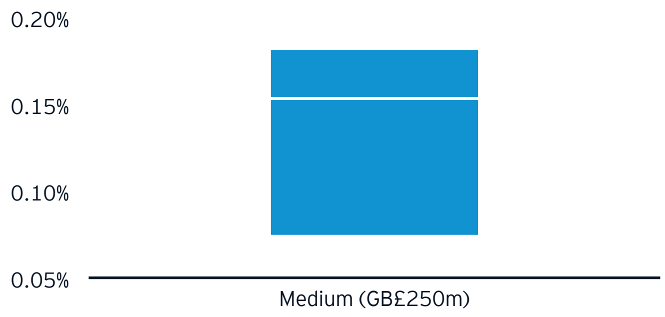
3. Methodologies

Very similar trading strategies can have wildly different costs (which can even be negative) make them difficult to compare on a like for like basis. These estimates can be highly subjective and based on number of factors and underlying assumptions.

In some cases the variations were due to different calculation methodologies/omissions.

The basis for calculating the ongoing transaction costs should be considered before evaluating the costs.

Figure 5: Ongoing transaction costs for scheme with GB£250m of assets.

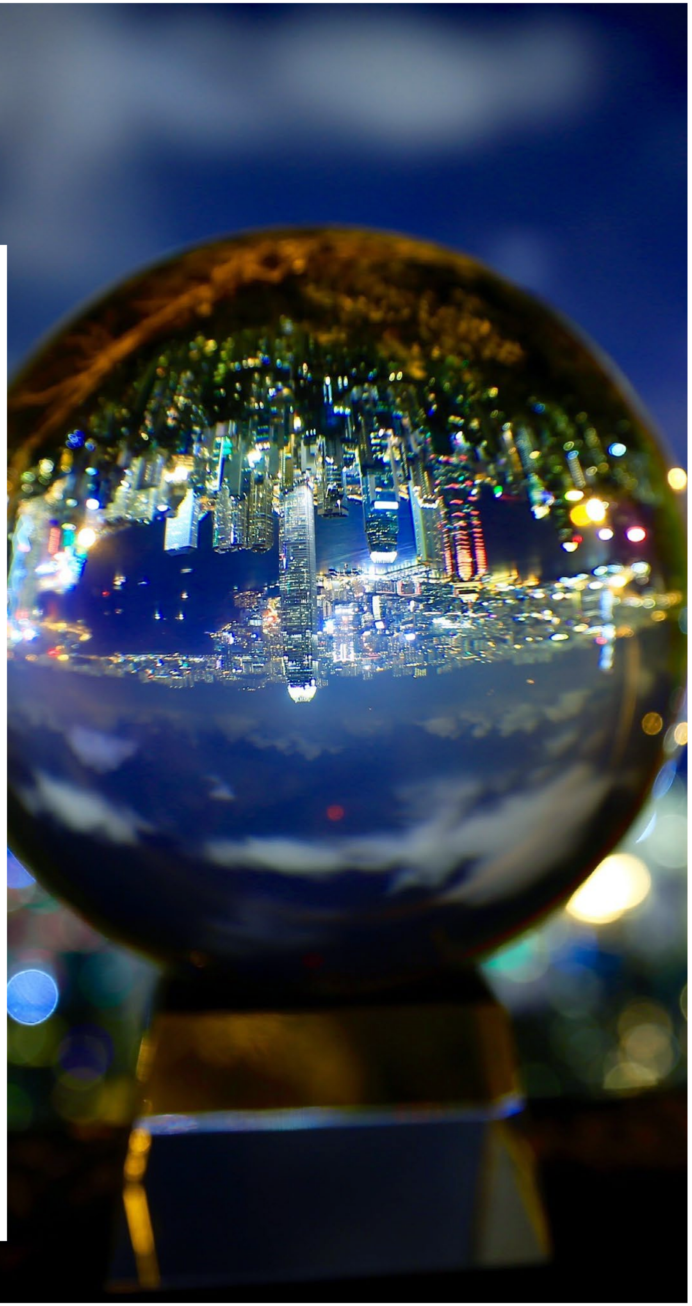


EY Insight:

In line with our 2020 ongoing transaction cost survey, we continue to see a significant variation in the overall ongoing transaction costs disclosed by fiduciary managers, differing by more than 0.4% p.a. MiFID guidelines can be interpreted differently, therefore the costs for the same funds can be reported differently, making comparisons less meaningful.

An in-depth understanding of portfolio content and structure should be considered to really assess value for money.

Please see our **Fiduciary management ongoing transaction costs survey – October 2020** for more details.



How EY teams 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 teams 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.

ey.com/en_gl/consulting/investment-governance-oversight

Contacts

We would welcome the opportunity to discuss how we can support you in your governance ambitions. Please contact us if you would like to know more.

Iain Brown
Partner
Ernst & Young LLP
T: + 44 20 7951 7546
E: ibrown1@uk.ey.com

Rikhav Shah
Director
Ernst & Young LLP
T: + 44 20 7951 8499
E: rshah10@uk.ey.com

Jonathan Craddock
Manager
Ernst & Young LLP
T: + 44 20 7951 8690
E: jonathan.craddock@uk.ey.com

Yanlin Wu
Manager
Ernst & Young LLP
T: + 44 20 7951 7116
E: yanlin.wu@uk.ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

About EY-Parthenon

EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their eco-systems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized — helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

EYG no. 006450-21Gbl
ED None

EYUK-000140404.indd (UK) 08/21.
Artwork by Creative London.

ey.com