Where is your money going?

Aon Hewitt's Sion Cole examines why it is important for investors to look beyond the headline number and get full fee transparency

In the current low return and high volatile environment, fees and costs are more important than ever. In particular, the amount of money paid for investment management services, including fiduciary management, is receiving heightened attention.

Understanding fiduciary management fees

Fiduciary management fees are more than just a headline number. At a simplistic level they can be broken down into four main components: fiduciary provider fees; underlying manager fees; investment consultancy fees and other fees such as admin, custody and legal.

Each component will vary between providers and depend on the solution offered. For example, the underlying manager fees will vary depending on whether an active or passive strategy is implemented, the types of asset classes used and the growth/matching split.

Within each of these components it is important to understand how that fee is made up (what sub-components are there) and who is being paid. For example, within the underlying manager fees, what fees are being paid to external managers and which remain with the fiduciary provider as a result of using their own in-house funds? There are also various total expense ratio fees and fund wrapper charges to understand such as admin, directors' and auditors' fees etc. This might apply at the individual fund level and at the overall fiduciary provider's wrapper level.

How are the provider's fees charged?

Fiduciary providers should be able to charge their fees in the form preferred by the client. Clients can choose to pay a base fee (eg a percentage of assets), a variable fee (which is partly driven by some form of metric such as funding level improvements) or a combination of both. If it is important for an investor to have aligned interests with the provider, requesting a fee that includes a variable element could prove to be valuable.

'Bundled or unbundled'

Another consideration is how are the fees structured? A bundled fee is where the provider will charge one complete fee with all services included (incorporating all four components). This means certainty of costs and allows easier comparison between providers. However, costs of individual services are not split out which prevents transparency and schemes could end up paying a higher charge then necessary. For example, if cheaper managers are used, the scheme will not see any reduction in its fee (while the bundled provider will see a rise in their profits). It is also important to note that 'bundled' doesn't always include everything so it is worth checking, as admin or custody are often in addition to the 'bundled' fee.

An unbundled fee structure is becoming increasingly popular. This approach separates all the component fees within the solution and gives greater transparency. Any savings, for example as the scheme de-risks over time and moves into cheaper matching assets, are also passed directly onto the client. More importantly, any fee savings negotiated by the provider are also passed through to the client. We are advocates of this approach as it provides investors with a breakdown of what costs are incurred and whom the fees will be paid to, allowing for maximum transparency.

An unbundled approach offers transparency, but there may not be certainty on the total cost (as per a bundled approach). It is important that trustees decide which approach they are most comfortable with – this is very much a client-specific decision.

Transparency should be compulsory

There are many aspects of fees to consider when it comes to fiduciary management (and across the wider pensions industry). Fees can vary significantly between providers and the way they structure and quote their fees will also differ.

We strongly believe that full transparency on all aspects of fees is a must and encourage all providers to offer this up front. Trustees should also delve beneath the headline fee and ask the questions necessary to make sure they are comfortable with the answers.

Key questions

- What is the fee?
- Who is being paid?
- How are they paid?
- Are the interests aligned?
- What services are you getting for your money?

Aon Hewitt's seventh annual *Fiduciary Management Survey* is now available. Read the latest trends and insights: aonhewitt.co.uk/delegatedconsulting

Written by Sion Cole, partner and head of European distribution within Aon Hewitt's fiduciary business
sion.cole.2@aonhewitt.com / 020 7086 9432