Reviewing Investment Management Charges

"Do these charges represent value for money?"
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Background

It is important for pension scheme trustees to monitor whether the fees charged by their investment manager are reasonable. This is particularly important in defined contribution schemes, where charges are generally borne by the member and could potentially have a significant impact on their final retirement savings.

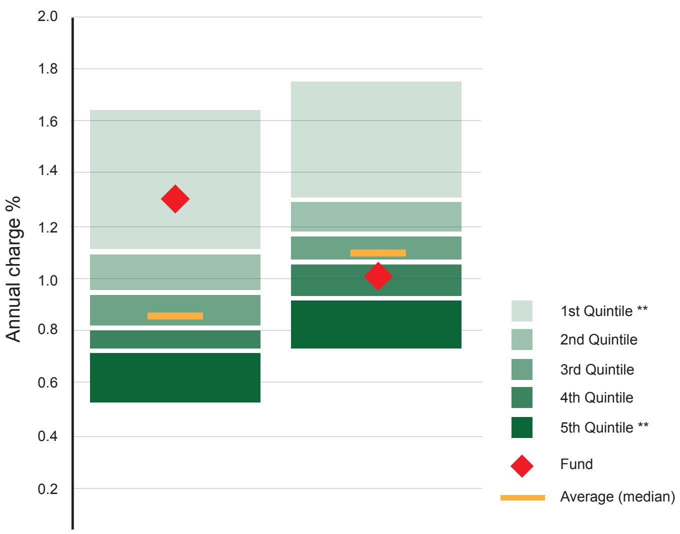
Guernsey's new pensions regulatory framework requires charges deducted from members' accounts to be reasonable and transparent*. Scheme members must to be notified where fees are deemed to be unusual or outside current market practice. However a stronger test is do these charges represent value for money?

Value for Money

A value for money assessment considers the level of the charges in conjunction with the quality and scope of the services provided, comparing them with other options in the market.

For example, a fund may not have delivered value for money even if its charges were average but it had suffered from poor performance. Equally, a fund with modest outperformance but well above average charges might also be considered to be poor value for money.

Trustees of UK pension schemes must check charges borne by members annually to see if they represent value for members. This assessment covers all member borne charges, including administration, governance and investment management charges.



Data source: Morningstar: Schemes qualifying for institutional share classes

Enforcement action on "Closet Trackers"

A recent investigation by the Financial Conduct Authority (FCA) into UK domiciled funds resulted in compensation of £34m being paid to investors who have overpaid for "Closet Tracker" funds. These funds provided index tracking performance but charged active management (higher) fees.

Normally when considering poor value for an active fund, attention is drawn to a high level of charges or poor performance. However in these cases neither of these may have applied; the funds involved were providing poor value for money, compared to the cost of index tracking funds, which would have very much lower fees. The FCA looked into 84 potential closet tracker funds and demanded changes to the marketing material of 64 of them to improve transparency for their clients.

The FCA has estimated that there is about £109bn sitting in "partly active" funds which are charging fully active fees. While these funds may be adequately disclosing how they invest, they may still be providing poor value for money.

Charges Review

To avoid similar issues, trustees may wish to carry out a review of charges. This includes an assessment of whether the existing investment management charges represent good value, as well as considering some or all of the following:

- total charges including, where possible, transaction costs
- performance delivered net of fees
- level and quality of services provided
- cost of equivalent funds

The chart illustrates the results of a charges review for two different funds. It shows the actual fees on each fund, relative to the range of fees available within that market sector. The funds are ranked by their charges; a position higher up the chart reflects higher charges.

In this example the US Equities Fund's charges were above the sector average and in the top 20% most expensive funds. However, the Emerging Markets Equity Fund had below average charges. This information, taken together with the performance and level of service provided, would determine if the fund represented value for money.

A charges review also provides an opportunity to consider whether any scale discounts would be available on charges. In view of the growth in investments, better terms may now be available.

* Sections 10.1 and 10.12.1 of the GFSC's Scheme Rules (No 2) 2017

** The top and bottom 5% of funds have been removed