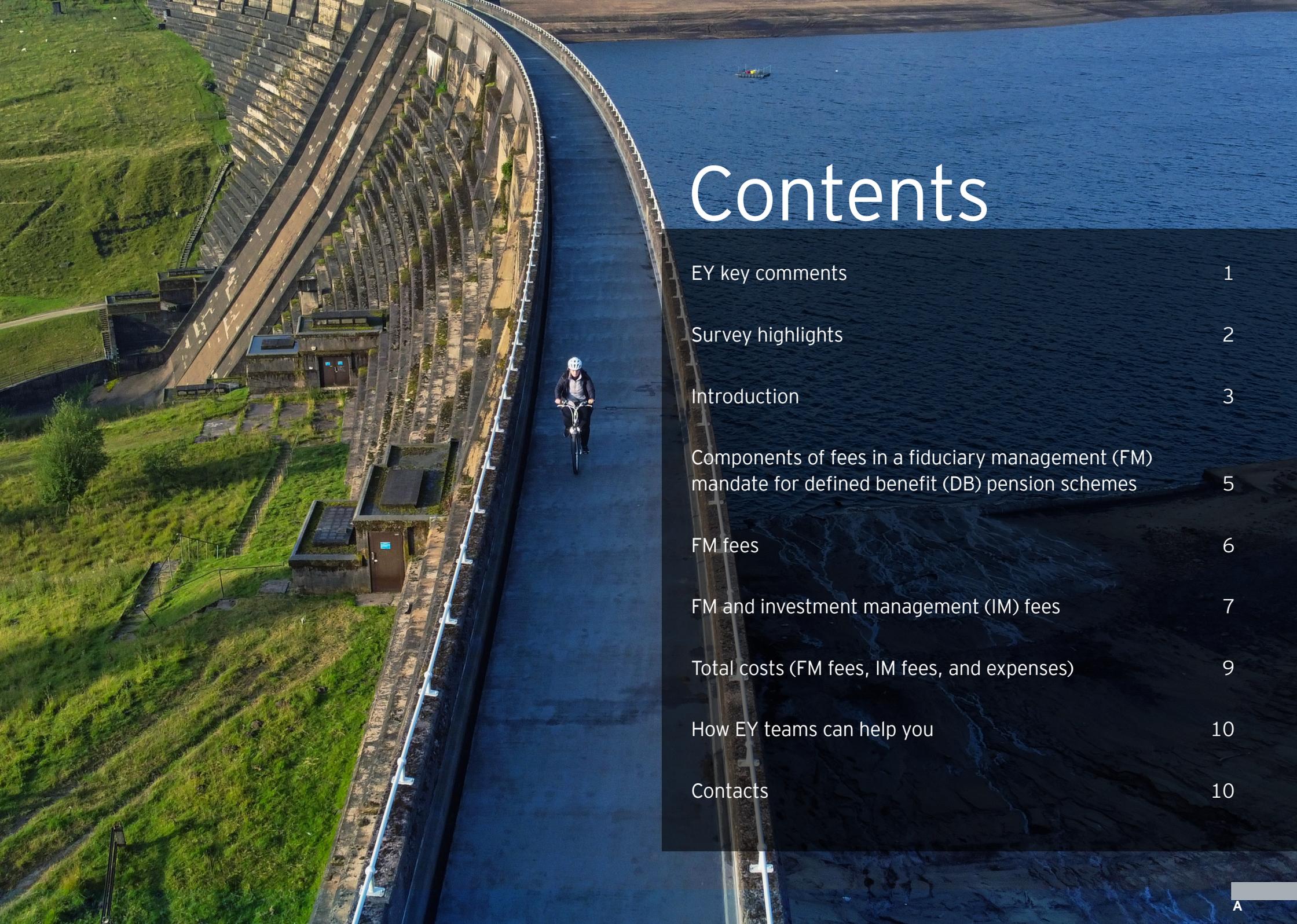


2023 fiduciary management fees survey

Sixth edition

December 2023



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EY key comments

“As always, the fee survey gives a thorough breakdown of fees in the market, the range across various components and the general trend we are seeing. Our thanks of course to the fiduciary managers for their contribution and transparency.

The key cost issues in 2023, and perhaps going into 2024, encompass transparency and structure. While transparency of costs has significantly improved over the years, we must continue to push for greater transparency given its importance to value for money assessments.

On the structure side, comes the impact of lower asset values across the board; while most schemes’ fees in pound amounts may be lower, the commonplace linkage to asset values means they may also be facing a fee restructure and/or potential basis point increase. I expect these discussions to be scheme-specific, and will no doubt include a number of factors in order to assess the overall value of the service. Hopefully the data within this report can be used to support both increased transparency, and discussions about structure.”

Kevin Humpherson, Partner



Survey highlights

Fee transparency can improve

Although fiduciary managers have been driving a significant increase in fee transparency over the past few years, there remains scope for improvement.

EY teams are seeing greater overlap of FM fees being charged through internal investment funds or private market products, as well as the IM fees.

It is important for trustees to understand the components of fees, what is being charged, for what services, and by whom. This facilitates a clear understanding of services and value provided, as well as ensuring that appropriate comparisons can be made.

Evolving fee structure

Historically, it has been common to have a fixed FM fee structure (either in monetary terms, or as a percentage of the overall assets), with only a few FMs having performance-related fees.

During 2023, we noticed that use of a tiered FM fee structure was increasingly popular over a fixed fee structure.

Trustees may expect to see more discussions around changing FM fees (either structure or amount) given higher inflation and shrinking scheme assets.

IM fees are a component of an investment strategy

IM fees are often the largest contribution to total fees, and these fees vary significantly depending on the target return, asset class allocation, and portfolio construction. Of the latter two, we often see very different approaches among different fiduciary managers.

IM fees should be considered in the context of the investment strategy being proposed/managed and not in isolation. The lowest fee may not be aligned with a scheme's requirements or investment beliefs.

Trustees should first consider whether the investment strategy meets their beliefs and objectives, and secondly if there is sufficient value for money being generated by this approach.

FM fees for end-game solutions are relatively unknown

There is generally a fall in total fees across all scheme sizes as schemes reduce target return; however, these reductions are largely due to change of IM fees (not FM fees), as liability-matching type assets tend to be less costly than return-seeking assets.

There is a discussion to be had as to whether FM fees should be higher, lower, or the same for end-game solutions.

FM fees should be reviewed throughout the de-risking journey to ensure that the level of fees payable are in line with the services being provided.

Introduction

EY teams have been conducting FM fee surveys since 2013. In the past few years, we have seen an improvement in the transparency of fees and costs. This survey aims to provide trustees and sponsors with information to help assess whether their FM arrangements provide value for money.

With more demand for FM 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 FM fees, IM fees and expenses that would be incurred.

Our purpose:

Strive to improve transparency from fiduciary managers and educate trustees to ensure that decisions are well informed.

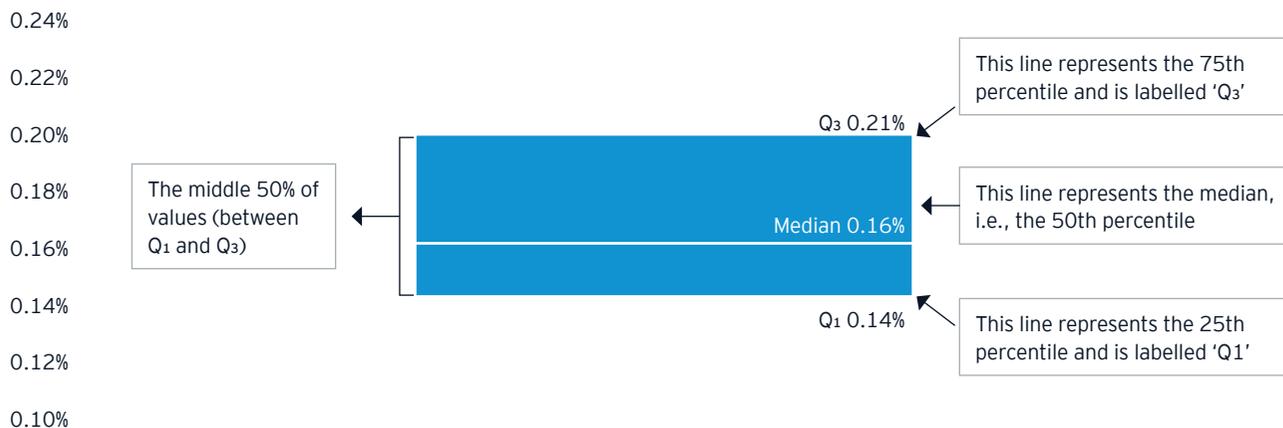


In a rapidly changing fiduciary environment, underlying portfolios and associated fees are evolving which makes an in-depth understanding paramount for effective scheme governance.

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

Example – FM fees (2023)



Using this survey

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Services provided by fiduciary managers

FM typically covers the full range of investment services that a pension scheme requires. 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.

Fee arrangements between schemes and their fiduciary manager need to take account of trustees' specific requirements, including any portfolio constraints.

EY teams have observed a variety of different FM 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 comparisons, we gave the fiduciary managers responding to our survey 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 DB FM industry. Of these 15 fiduciary managers, two provided two fiduciary solutions and one provided three fiduciary solutions. Therefore the survey is based on 19 different UK solutions. We would like to extend our gratitude to the FM industry for their participation.

Hypothetical DB pension schemes

There are a number of providers of FM 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 our previous fee 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 have 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**

A target return of liabilities **+1.5% pa**

As pension schemes' funding levels improve, there are 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 **+0.75% pa**

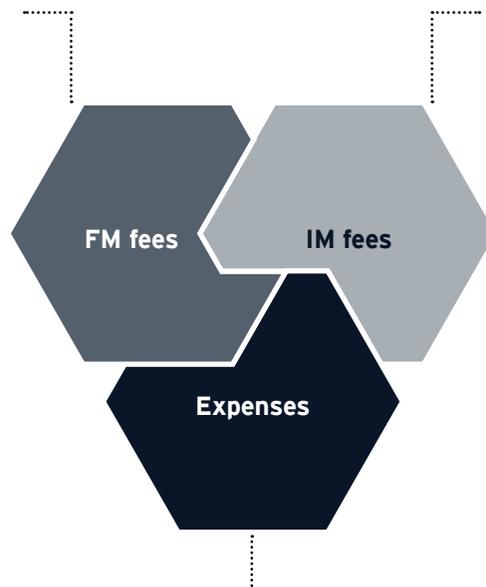
Components of fees in a fiduciary management (FM) mandate for defined benefit (DB) pension schemes

Components of fees

The fees in a FM 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 modeling and setting the investment strategy) and implementation of the investment strategy (including manager selection, tactical asset allocation and implementation of hedges). There may be a performance-related component to the FM fees.



Expenses

There can be other costs and expenses associated with a FM mandate. Such expenses may or may not be included in the FM fees or IM 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.

EY teams

There is a large variation in how these three fee components are applied by fiduciary managers:

- ▶ Some FMs will implement through internal investment funds. They will therefore quote lower FM fees, and recoup revenue from IM fees charged on their internal funds.
- ▶ Some FMs will charge separate fees (in addition to the base FM fees) for managing private market investments, liability hedging assets or special downside protection strategies.
- ▶ Some FMs have blended FM expenses within their FM fees, while others have quoted them separately.

It is important for trustees to understand what is being charged. Without an in-depth understanding of fee content and structure, decisions can be made based on data that is not comparable.

FM fees



FM fees have typically been charged as a percentage of assets; however, there are a variety 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 FM fees for UK DB pension schemes changed since 2013?

As in our previous surveys, the 2023 results show a reduction in FM fees (as a percentage of assets) as the asset value increases. The median annual FM fees fell from 0.25% to 0.09% as scheme size increased 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.

As shown in the graph below, the median level of FM fees stayed fairly similar to the results of our 2021 survey, across all scheme sizes.

Figure 1: FM fees since 2013



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

EY teams

A variety of different fee structures are available in the FM market.

- Historically, the majority of FMs prefer to structure their FM fees as a fixed percentage of the overall assets.
- Around 25% of FMs offer tiered charging structure to account for situations where scheme's assets change materially.
- One-third of the FMs have performance-related FM fees for some of their existing clients.

Due to rising interest rates and recent market turmoil, we've witnessed a material decline in pension assets over the past year, which led to a material fall in FM fees in £-terms (which largely depend on scheme's asset size). Furthermore, the running costs (e.g., human capital) increased as a result of increasing inflation. As a result, some fiduciary managers struggled to keep their profitability. EY teams have observed that some fiduciary managers have started to change their fee structure from the original flat fixed percentage of the overall assets, to a tiered fee structure. We expect to see a continuation of this trend in coming months.

We understand that due to declining pension assets, that some FMs are trying to change their fee structure in order to protect their FM fees in £-terms. However, trustees should consider whether new fee structures remain appropriate in the event that asset size grows back to the original level. In addition, an important question that trustees should ask is whether a new fee structure results in their scheme being overcharged by its fiduciary manager. The level of FM fees should be reviewed periodically.

FM and investment management (IM) fees



IM fees, shown as a percentage of assets, vary as the underlying portfolio changes.

Our view is that it is important to consider the FM fees and IM fees together when evaluating a FM fee proposal.

As in our previous surveys, this survey shows that the total of FM and IM fees have continued to fall for schemes targeting investment return of liabilities +2.5% p.a.. The median level of annual FM+IM fees fell from 0.45% to 0.33% as scheme size increased from GB£50m to GB£1.5b.

Figure 2: Interquartile range (the middle 50% of values) of FM fees plus IM fees (excluding expenses)



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

It is becoming increasingly common for trustees of smaller schemes to change their governance model to a FM set up. Comparing to the results of our 2021 survey, the median level of FM+IM fees have fallen sharply by over 20% for small schemes.

EY teams

The total fees (excluding expenses) have a high dependency on the asset classes included within the mandate.

Given a challenging market environment, pension schemes continue to seek alternative return sources and to improve diversification. Therefore, we have seen a higher reliance on alternative assets for pensions schemes in recent years. There has been an increasing number of sub-categories developed under each asset class (for example, Long Lease Property, Core property vs real estate investment trusts (REITs)). Different sub-categories have a specific style or strategy bias, while others use a more balanced approach, which has an implication on the IM fees being charged.

There are various charging structures for liability driven investments (LDI) assets, some are based on the total notional hedged exposure, while others are based on invested assets. This survey expresses IM fees of LDI as a percentage of assets, and these fees have decreased across all scheme sizes comparing to our 2021 survey. This is a natural outcome given that most LDI providers de-levered their LDI portfolios post last year's 'gilt crisis'.

When comparing the fees of different fiduciary arrangements, it is important to assess the fees relative to the construction of the portfolio, as well as the content of the overall fiduciary service. The lowest fee may not be aligned with a scheme's requirements or investment beliefs, and thus a deeper understanding of the breakdown of fees and portfolio allocation is crucial in order to make an informed decision around value for money.

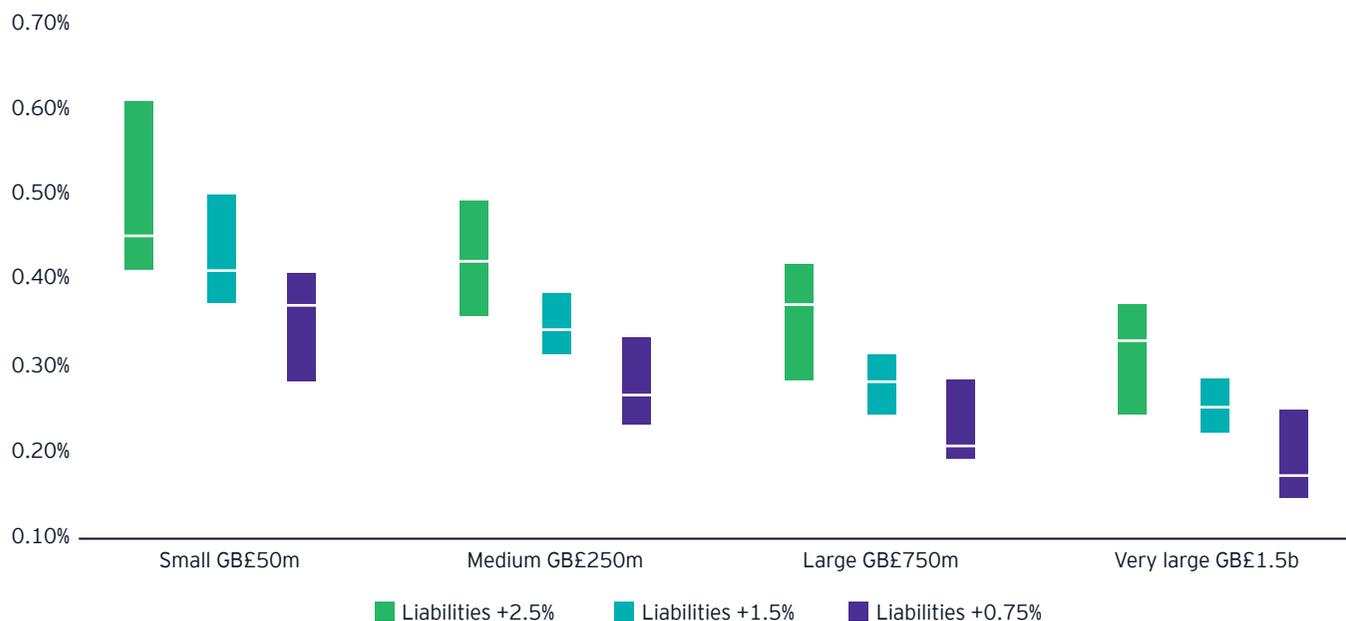
FM fees and IM fees (continued)



End-game solutions

As funding levels improve, an increasing number of pension schemes are getting closer to maturity, meaning that many pension schemes have started to de-risk their portfolios, reducing investment risk and targeting a lower investment return. We have seen an increasing number of providers that are offering solutions for such schemes, with an increased focus on cashflow matching. Therefore, we have captured the relative fees of schemes targeting liabilities +2.5% p.a., liabilities +1.5% p.a. and liabilities +0.75% p.a. in our survey.

Figure 3: Interquartile range of FM+IM fees (excluding expenses) for schemes targeting investment returns of Gilts +2.5% p.a., Gilts +1.5% p.a. and Gilts +0.75% p.a. return



EY teams

EY teams have observed a fall in total fees (excluding expenses) by c. 20% across all scheme sizes, as a result of schemes reducing their return target from liabilities +2.5% p.a. to liabilities +1.5% p.a.. We have also observed a further fee reduction of 20%-30% when the target return was reduced to liabilities +0.75% p.a.

The drop in total fees is mainly due to the lower IM fees in portfolios with a higher allocation to cashflow matching and liability hedging assets, as schemes move closer to their end-game solutions. These assets are more passive in nature, and have lower IM fees than return-seeking assets.

EY teams

Surprisingly, our 2023 survey shows that the FM fees are very similar for schemes targeting Gilts +2.5% and Gilts +1.5% across all scheme size, and reduced slightly for schemes targeting Gilts +0.75% p.a.

FM fees should be reviewed periodically (especially there is a change of mandate), in order to ensure the level of fees payable are in line with the details of the mandate, and ensuring overall value for money from their FM services.

Total costs (FM fees, IM fees and expenses)



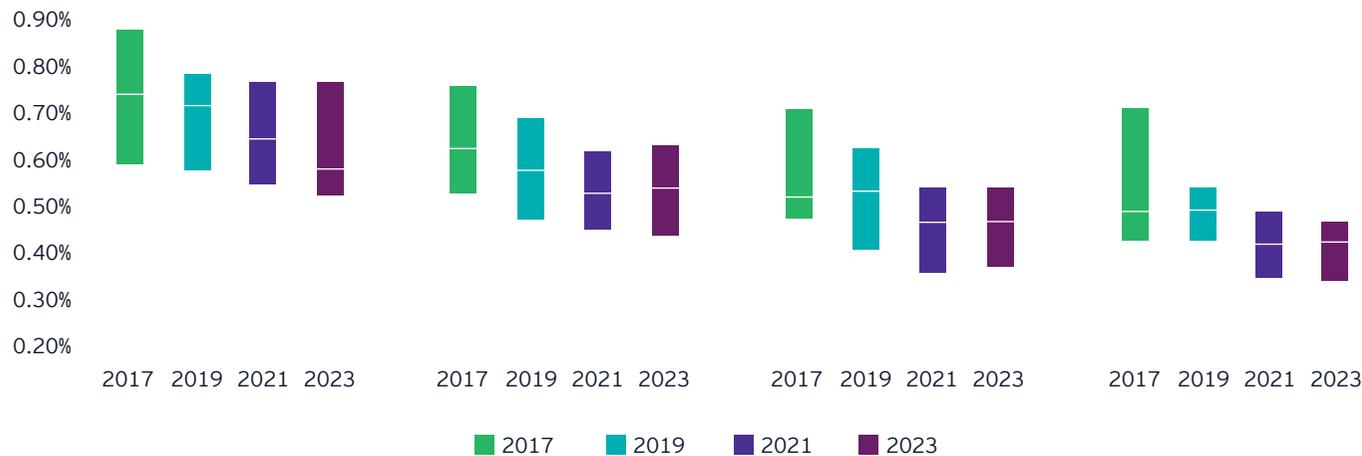
Expenses are the final component of costs within an fiduciary mandate. These include expenses incurred by the fiduciary manager, as well as expenses incurred by the underlying investment managers.

There are various explicit and implicit expenses which ought to be considered as part of the total costs, 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
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Expenses are often overlooked when evaluating provider fee arrangements. This is sometimes due to low transparency, but is also often simply ignored. We believe that investors should look at total costs, and hence aim to identify all fees and expenses which would be incurred as part of the mandate, which ultimately detract from net investment returns.

Figure 4: Interquartile range of total costs (including expenses) for schemes targeting investment returns of Gilts +2.5% p.a.



EY teams

Expenses can be a non-trivial drag on returns; they can constitute over 30% of the total costs, depending on scheme size and type of solution.

Our 2023 survey shows a rise in the expenses across all scheme sizes. It is critical that expenses are considered as a key part of the fee proposal evaluation process.

We have also noticed that a small number of fiduciary managers have included some types of expenses (e.g., administration and performance measurement fees) within their FM fees. Therefore, without a proper understanding of the fees and expenses, comparison across the market can be misleading.

Since our prior surveys, we have seen a decrease in the median level of total costs (including expenses) for small schemes. However, this has remained at a similar level for all other scheme sizes.

How EY teams can help you

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

EY teams provide 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.

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.



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