



## Clive Gilchrist

# Trustees should boycott high fees

At a conference recently, I heard the head of a leading investment consultancy criticise trustees for overpaying investment managers. He said we should pay the managers less and invest the savings on asset allocation advice and strengthening scheme governance.

The argument that trustees should invest greater time and resource on asset allocation is not a new one; to quote Myners principle three: "Strategic asset allocation decisions should receive a level of attention (and, where relevant, advisory or management fees) that fully reflect the contribution they can make towards achieving the fund's investment objective."

The suggestion that we overpay our investment managers is not new either; trustees often feel we fail to obtain value for money. What was new though, and irritated various pension managers sitting around me in the audience, was the implication that they don't try to negotiate fees.

A small scheme, like any other small customer, is effectively a price taker, having little choice but to accept the price on offer. A large scheme, on the other hand, can generally negotiate a better deal - and they do try.

This came to mind when I read that the California Public Employees' Retirement System (CalPERS) is coming to the view that they should pay only performance-related fees with no base fee at all. The penalty for poor performance would be no fee - though managers think that their penalty for poor performance is to lose the client.

Trustees don't want the underperformance that accompanies zero fees; what we want is to pay a fair price in return for the performance we are led to expect. Whether good value is best achieved by performance fees or by paying a straightforward ad valorem fee is a question that some trustees feel strongly about; my view is that it depends on the circumstances.

I think trustees should compare what is on offer; consider how a performance fee scale compares to the flat fee alternative on various scenarios - underperformance, benchmark index performance, target outperformance, and superior outperformance. They should also look at the timescale for measurement; paying a performance fee that is not clawed back by immediate subsequent underperformance is clearly unattractive.

CalPERS have concluded that performance fees best suit their objectives. Other trustees may find, as I have frequently done, that it is easier to negotiate a satisfactory flat fee than accept a performance fee that is all too often skewed in favour of the manager - the penalty for mediocre or poor performance is negligible compared to the outperformance bonus.

This brings me back to the consultant's criticism. Trustees depend on their investment consultants; if they think fees are too high for certain managers or certain asset classes, why don't they say so and remove them from shortlists?