

FIRST WATCH

With an increased emphasis on governance, plan sponsors are demanding greater fee transparency—and holding money managers accountable

By Joel Kranc

For many plan sponsors, there is no time like the present to assess how they are directing their efforts—especially when it comes to fees and performance. These aspects of plan management have always been on the minds of plan sponsors. However, the Great Recession, which took a severe toll on DB and DC assets, has encouraged plan sponsors to look at fees and performance more carefully as well as their motivations for choosing one manager over another. And while fees are rarely the straw that breaks the camel's back—in terms of manager selection or dismissal—they do provide a jumping-off point for managers, consultants and plan sponsors to address other issues, such as plan governance and risk management.

A Question of Fees

When you engage an investment manager to handle your plan's assets, how do you know if the fees you're paying are appropriate? According to David Service, director of investment consulting with Towers Watson in Toronto, "...a manager's performance will be partially alpha (manager skill) and partially market-driven, or beta. Fees should be roughly a third of the expected alpha. That statement applies across all asset classes." In fact, he says, unless a very large mandate is at play, negotiating fees doesn't happen very often.

Benefits
CANADA

**WORKPLACE
HEALTH &
BENEFITS
AWARDS 2011**

**Celebrate
with Us!**

OCTOBER 13, 2011
FAIRMONT ROYAL YORK HOTEL,
IMPERIAL BALLROOM, TORONTO

5:30 PM - COCKTAIL RECEPTION
7:00 PM - DINNER AND AWARDS CEREMONY

The Workplace Health & Benefits Awards will honour organizations and individuals who have demonstrated leadership and innovation—and who have made a real difference in the group benefits industry. Join us in celebrating their achievements.

Book Your Table Today:
benefitscanada.com/benefitsawards

TABLE OF 8 - \$2,200 SINGLE TICKET - \$299

FOR SPONSORSHIP OPPORTUNITIES,
contact Francesca Gibson at (416) 764-3883
or francesca.gibson@rci.rogers.com

SPONSORED BY:



“People want to understand what they’re being charged. If performance is expected to be lower than in the past, you are eating up a greater portion of the performance the higher the fees are.”

– Ryan Kuruliak, vice-president,
Proteus Performance Management

However, the fees that plan sponsors pay—and how significant a role they play in decision-making—will depend, in part, on the type of investments under management. Alternative investments such as real estate and infrastructure, or more complicated vehicles such as hedge funds, are more prone to fee negotiations. Ryan Kuruliak, vice-president with Proteus Performance Management in Toronto, says that on the DB side, pay for performance has been much more common in the hedge fund and alternative space.

Service agrees, noting that there has been a lot of pushback from plan sponsors on the alternative fee model (often, a flat fee plus a carry charge above an agreed-upon threshold). He says it comes down to an assessment of where skill is being deployed: for example, if a manager is buying real estate with the intent of developing it, that’s a riskier prospect for the manager than buying an existing toll road or mall that is already fully functional.

Overall, fee awareness has been rising in light of the Great Recession and as a part of the evolutionary trajectory. “I would say the solvency deficiencies [caused by the Great Recession] are causing heightened scrutiny,” says Stephanie Kalinowski, a partner in the pension and benefits group with Hicks Morley in Toronto. Kuruliak agrees. “People want to understand what they’re being charged. If performance is expected to be lower than in the past, you are eating up a greater portion of the performance the higher the fees are.”

Driving Good Governance

The Great Recession may be one reason behind this increased fee awareness. But according to Kalinowski and others, fees are negotiated at the outset of the relationship—therefore, there has generally not been a direct linkage between the financial crisis and performance. “Shopping around has been driven by

performance concerns, not by fee concerns,” says Kalinowski. “Fees are a factor, but I wouldn’t say for most clients they’re a driving factor.” Robin Pond, senior investment and DC consultant with Buck Global Investment Advisors in Toronto, agrees, adding that performance is looked at as a relative rather than as an absolute.

What’s interesting to note is that plan sponsors were looking at performance issues long before the crisis—and putting managers on watch where performance had become an issue. Pond agrees that greater scrutiny of fees is emerging, noting that transparency and monitoring of fees have become more important. While he admits that the economic crisis has made plan sponsors more “fee-sensitive,” he says the evolving concept of good governance has been the driving factor. “The more people become aware of proper techniques of plan management, the more they will look at things like, How much are we paying?”

Trends emerging out of the U.S. are also driving this evolution. Pond explains that over the past five or 10 years, plan sponsors have really pushed managers on fees and fee structures. “In the performance evaluation reports that we do quarterly for DB plans, we now will often put in a fee universe, and where the manager is in that fee universe.” These days, many of those requests come from larger U.S. companies and their Canadian subsidiaries, he adds. As larger plan sponsors start requesting more fee information, this trend will likely trickle down to mid-size and smaller plan sponsors as well.

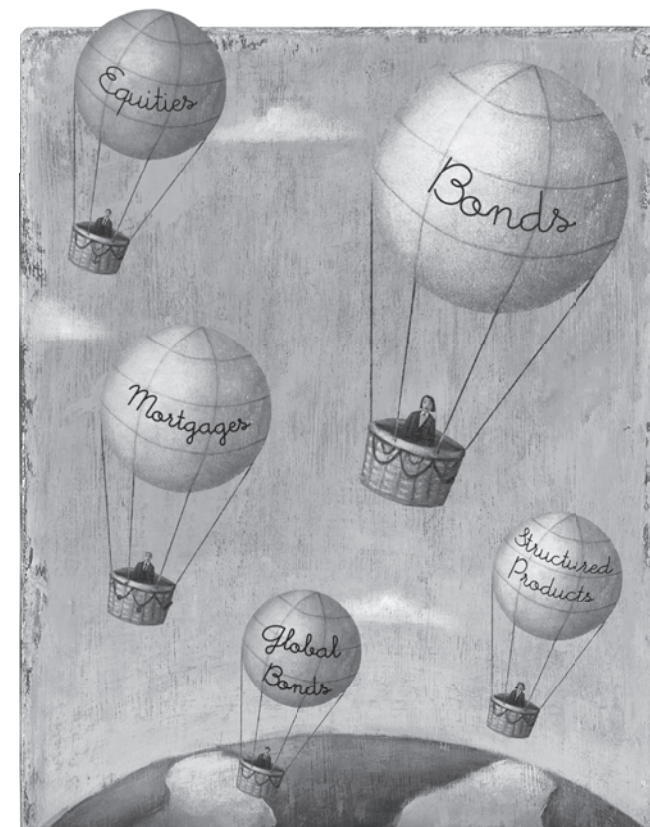
An increased focus on governance has also influenced how plan sponsors manage costs in light of their overall business demands. Kalinowski notes that investment performance is often first and foremost in a plan administrator’s mind. The question then becomes, Is the plan getting value for the fees it’s paying managers for the expected performance?

Linking Fees and Performance

How can plan sponsors better link investment management fees with manager performance? One emerging option is performance-based fees. Pier 21 Asset Management in Montreal, for example, has created a fee schedule that comes to zero if an agreed-upon benchmark is not met. Anything earned after 50 basis points is shared with the client, but fees are capped at certain levels rather than just taking a percentage of the performance, according to David Star, the company’s president and CEO.

“The common trends in the institutional space are how plan sponsors can de-risk their plans and better master their liabilities,” says Star. By offering benchmark-agnostic funds with absolute return long-only strategies, plan sponsors have a diversifier to help them de-risk. “Fees, we felt, were part of the de-risking mix.” Using de-risking and liability matching as a basis for selecting a manager allows you to define performance in a less traditional way, he adds.

Service agrees that plan sponsors are looking at de-risking in their plan structures and in how they view managers. “That is the biggest change [since the Great Recession]. You see plans putting in place specific programs that will reduce the mismatch risk where assets don’t behave like the liabilities.”



The world of investment management from a different perspective

Providing customized investment solutions that perfectly suit your needs.

Addenda Capital adds value through its disciplined investment processes.

For more information please contact:

Martin Labrecque
Vice-President, Client Service & Product Development
514.287.7373
m.labrecque@addenda-capital.com

addenda-capital.com



ADDENDA Stands for Added Value

small BUSINESS ADVISOR WEEK

OCTOBER 10-14

**Rogers Publishing
is pleased to announce
Small Business Advisor Week,
brought to you by
Manulife Financial.**

Look for a full research report
on small business owners,
plus a complete toolkit of
resources beginning October 10.

Brought to you by

 **Manulife Financial**
| For your future™

 **ROGERS™**

He adds that while people have been talking about de-risking ever since the dot-com bubble, not much progress was made—but that's changing. "CFOs have finally gotten the message and are going to act."

The challenge with performance-based fees, however, is finding a structure that works. With traditional asset classes in stocks or bonds, plan sponsors will have a harder time assigning proper benchmarks and monitoring performance. Says Service, "The key is to define the mandate properly and be clear in what you expect from your manager. If you hire managers who are benchmark-agnostic, you have to be patient because the market will do what it will do—it could purely be a matter of style." Pond agrees. "[Performance-based fees] are problematic in terms of defining the right benchmark. You don't want managers to take extreme bets to earn back anything they may have lost."


According to Kuruliak, the best advice to give clients is to carefully look at the asset classes in which the plan is investing. Only then can fees be addressed in a relative sense and the plan sponsor determine if it makes sense to pay active management fees for those particular classes. Kuruliak stresses that plan sponsors need to determine if their managers are able to protect on the downside or capture a meaningful part of the rebound. "Don't pay for alpha when all the manager has given you is beta."

Attention Shoppers

Even with transparency, good governance and benchmarks making their way into the psyche of the plan sponsor, there has been relatively little comparison-shopping on the DB side. It's a slightly different story on the DC side, where Pond and others are seeing moves by DC recordkeepers to provide greater transparency in their fee structures. Pond adds that while costs are prompting plan sponsors and their representatives to push for transparency, there is also a move by the industry as the thought of regulated fee disclosure creeps in.

Another key driver has been plan sponsors returning to their investment policies to examine their current choices versus those they are considering for the future. Kuruliak notes that plan sponsors are looking at managers and pushing fee issues to make sure their interests are aligned, and they're getting what they pay for. "Certainly, the awareness and understanding of fees has gone way up, and people want to understand what they're being charged—to know they are getting value for that."

Through myriad investment options, fee structures, performance histories and manager selections, plan sponsors are cautioned to ensure that their interests are aligned with their manager's strategy. And if the latest economic crisis has highlighted anything, it is that there is a lack of alignment between managers and their plan sponsor clients.

Alignment, coupled with the right investment policy and strategy, will better dictate the fee structures that are appropriate for the plan being managed. Markets will fluctuate, so transparency, governance and the methodology behind the investments will ultimately be the most influential factors in a plan sponsor's decision-making process. And while fees play a part in manager selection decisions, even in recessionary times, they are never the single driving factor. 

Joel Kranc is a freelance writer based in Toronto. joelkranc@gmail.com