

Delivering Robust Assessments of Value



Remarks & UK Market Overview



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FITZ Partners

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From an internal review process to governance requirements.

In this report we intend to share with readers what we see as crucial aspects of the quantitative part of the AoV. The remarks below are a summary of comments, queries or concerns many of our clients have shared with us over the last year before considering using our Board Reporting service as part of their assessment process.

In Spring 2018 the FCA (UK regulator) published the conclusions to its Asset Management Market Study in the form of a new policy statement requiring asset managers to undertake a periodic assessment of value of their fund products and their share classes. The value assessment requires qualitative and quantitative reviews of the following criteria:

- | | | |
|--------------------|----------------------|---------------------------|
| ✓ Costs | ✓ Economies of Scale | ✓ Comparable Services |
| ✓ Performance | ✓ Quality of Service | ✓ Comparable Market Rates |
| ✓ Classes of Units | | |

The first value assessment statements are due to be published in funds financial reports from 30th September 2019. Within four months following their reporting date, the Board of Directors, including newly appointed independent directors, will deliberate following their chosen internal review process which will command robust methodologies and accurate content, reflecting their fiduciary responsibilities.

AoV in one sentence: “Strengthening the duty on fund managers to act in the best interests of investors and introduce scrutiny of this”

FCA, PS18/8.

In mainland Europe, there are increasing talks that AoV might be introduced for UCITS funds in the not-so-distant future. Following the publication of ESMA’s annual report on the cost and performance of retail investment products, Steven Maijoor, Chair of ESMA commented on the need to see further focus on fund costs in Europe.

“It demonstrates [...] the need for asset managers and investment firms to take costs into account when acting in the best interest of investors.”

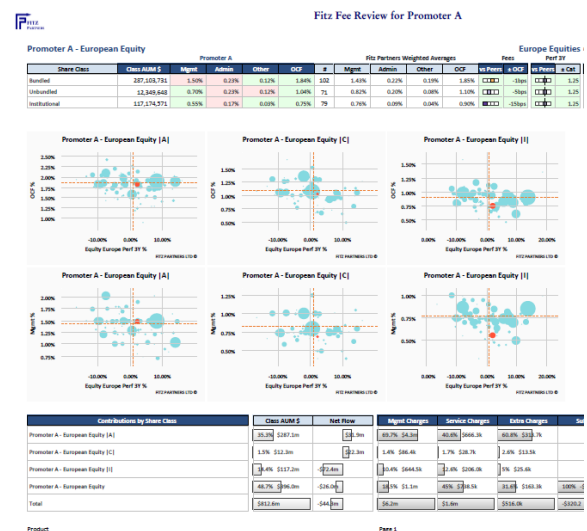
Chair of ESMA, January 2019

Treat Your Customer Fairly – Governance – Accountability.

Funds' value assessment is not just a question of transparency or yet another investor communication implementation alongside the current publication of regulatory or marketing materials. The industry and the regulators are probably past that point, it is about stronger governance and accountability.

In many ways the process of Assessment of Value (AoV) can be regarded as the final touch to the “Treat your Customer Fairly” (TCF) initiative which was initiated by the regulator over 10 years ago.

- The AoV is not about doing as well as most of the others, or aiming for the “median”, but looking in detail at what areas could be improved from peers’ positions and being comfortable with the current positioning of the share class or fund product.
- The benchmarking exercise is not a simple validation, but must become a means to either confirm the current position is regarded as optimum, considering the business requirements and clients’ needs, or to determine refreshed targets based in part on best-in-class principle.
- Any AoV process must also include an inward looking review of fund products. It is essential to compare share classes within the same fund product in order to highlight any possible investor “inequality”. One important aspect of the AoV linked to the fair treatment of investors resides in the assurance that no category of investors are treated differently from another and a review of share class relative level of revenue contribution or fee discount is essential.



Promoter A Summary Unbundled Share Classes

Share Class Name	Fitz Classification	Promoter A				Fitz Partners Weighted Averages				Peer	
		Asset Value \$	Asset	Other	Subsidiary	Asset	Other	Subsidiary	OCF	Asset vs Peer	OCF vs Peer
Promoter A - Corporate Income (F)	Europe Bonds	2,337,448,521	0.40%	0.25%	0.75%	0.38%	0.25%	0.80%	0.57%	***	175%
Promoter A - Global High Yield Bond (F)	Global High Yield Bonds	1,674,138,276	0.54%	0.00%	0.62%	0.58%	0.38%	0.80%	0.72%	***	150%
Promoter A - US Large Cap Growth Equity (F)	US Equities	1,591,262,967	0.53%	0.00%	0.88%	0.65%	0.22%	0.80%	0.57%	***	225%
Promoter A - Emerging Markets Equity (F)	Emerging Markets Equities	1,118,161,129	0.86%	0.11%	0.85%	0.85%	0.29%	0.80%	1.12%	***	415%
Promoter A - Alternative Growth (F)	US Equities	890,557,428	0.61%	0.29%	0.84%	0.61%	0.22%	0.80%	0.67%	***	121%
Promoter A - US Small Cap Growth Equity (F)	US Small Cap Equities	854,218,855	0.61%	0.00%	0.86%	0.65%	0.20%	0.80%	1.12%	***	485%
Promoter A - Global Core Equity (F)	Global Equities	809,154,615	0.61%	0.21%	0.84%	0.76%	0.20%	0.80%	1.08%	***	485%
Promoter A - Global Duration High Yield (F)	Global High Yield Bonds	695,388,250	0.49%	0.21%	0.72%	0.58%	0.38%	0.80%	0.72%	***	250%
Promoter A - Global Duration Equity (F)	For East Pacific Equities	652,479,854	0.86%	0.11%	0.85%	0.85%	0.29%	0.80%	1.12%	***	415%
Promoter A - Global Bond (F)	Global Bonds	751,151,888	0.49%	0.32%	0.62%	0.51%	0.20%	0.80%	0.76%	***	250%
Promoter A - Diversified Value Plus (F)	Global Bonds	686,158,881	0.49%	0.32%	0.60%	0.51%	0.20%	0.80%	0.76%	***	185%
Promoter A - Emerging Markets Debt (F)	Emerging Markets Bonds	654,161,811	0.49%	0.25%	0.72%	0.62%	0.22%	0.80%	0.67%	***	465%
Promoter A - US Large Cap Value Equity (F)	US Equities	653,429,621	0.51%	0.00%	0.67%	0.67%	0.22%	0.80%	0.57%	***	205%
Promoter A - Corporate Equity (F)	Europe Equities	586,462,423	0.51%	0.28%	0.88%	0.78%	0.24%	0.80%	0.90%	***	165%
Promoter A - Emerging Markets Growth (F)	Emerging Markets Equities	542,967,228	0.61%	0.36%	0.72%	0.61%	0.20%	0.80%	1.12%	***	255%
Promoter A - Emerging Income (F)	US Mortgage-Backed Securities	463,968,761	0.49%	0.25%	0.77%	0.49%	0.20%	0.80%	0.64%	***	115%
Promoter A - Global Growth Equity (F)	Global Equities	478,659,611	0.61%	0.28%	0.72%	0.76%	0.20%	0.80%	1.08%	***	225%
Promoter A - International Health Care (F)	Biotech/Healthcare Equities	468,861,210	0.86%	0.34%	1.20%	0.76%	0.20%	0.80%	0.84%	***	285%
Promoter A - Global Value (F)	Global Equities	424,164,815	0.61%	0.34%	0.87%	0.76%	0.20%	0.80%	1.08%	***	255%
Promoter A - Global Income Plus (F)	For East Pacific Bonds	421,851,889	0.49%	0.28%	0.69%	0.51%	0.20%	0.80%	0.76%	***	155%
Promoter A - Global Income Equity (F)	For East Pacific Equities	353,889,475	0.61%	0.31%	0.61%	1.12%	0.20%	0.80%	1.12%	***	255%
Promoter A - Global Plus Fixed Income (F)	Global Bonds	342,471,121	0.49%	0.22%	0.69%	0.51%	0.20%	0.80%	0.76%	***	155%

- Following a detailed review of each set of share classes, the Value Assessment will be built on the answers received by directors when going through their internal review process or their internal assessment template. It is crucial then, that the right questions are asked based on detailed, accurate and robust reviews.

Although Fitz Partners primarily provides quantitative content, which constitute the basis of the share class Value Assessment reviews, the qualitative aspect of the assessment would have to follow the same principle of robustness.

The use of Board Reporting or external reviews will be a starting point for internal and directors' discussions and it must be transparent, detailed and accurate enough to provide answers with a high degree of certainty and conviction of the soundness of any conclusions that are drawn from it.

The review or Board Report would need to address share class queries such as these:

- Where are we compared to corresponding share classes with similar objectives?
- Why are we where we are compared to others?
- What are the main drivers behind our and peers' current share class positioning?
- What are our peers doing better and can we match it?
- What can we do to deliver "best in class" investors' outcome?
- What is our evidence that all investors are treated with equal consideration?

The Starting Point: Board Reporting – Benchmarking – Fund Reviews

Let's not pretend that there can exist an end-to-end solution that would take care of the overall AoV process, providing all answers and describing "value" as a standard for all firms. Such a solution would most probably undermine in many respects boards' governance and their fiduciary responsibilities.

Fitz Board Reporting service provides the basis for internal and board discussions around "share class value". It only offers content and analysis to asset managers, but in a detailed, robust and precise manner so it can accurately answer boards' queries.

"[Regarding our AoV] the building of reliable share class peer groups is our starting point. Our overall assessment covering most of the FCA criteria will be derived from this [...]"

Global Asset Manager, February 2019

The most important aspect of any service supporting AoV is the quality of the data on which it is built as well as the robustness of its peer group construction.

It is important to note that Board Reporting or benchmarking services in the UK have now moved from what used to be an internal duty, usually requested by fee committees or product teams, to a regulatory requirement directed ultimately at the Board of Directors. This requires even more scrutiny as to the robustness of any benchmarking exercise that forms part of the Value Assessment.

Fitz Partners & Fund Governance Reporting

2005 - First European customised Board Reporting (Lipper-Fitzrovia).

2014 - Fitz Partners re-introduced Fee focused Board Report (UK & Cross-border)

2017 - Fitz Partners 15c style European Board Reporting service (UK & Cross-border)

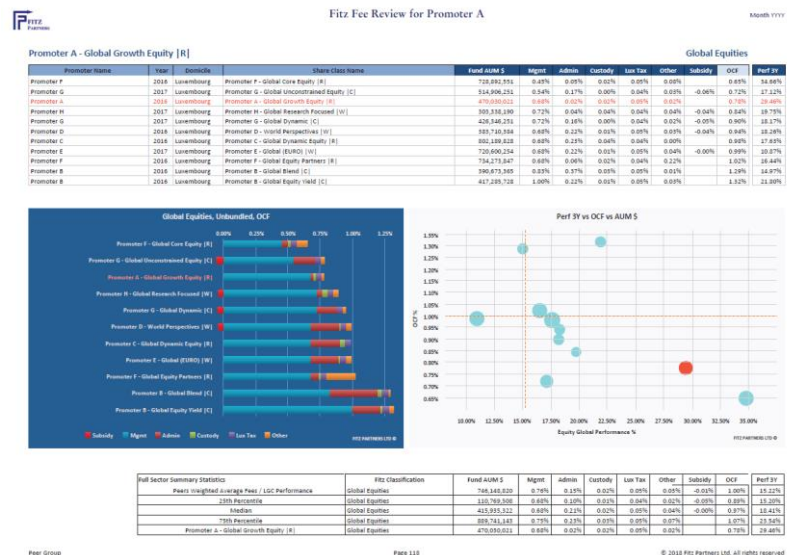
2018 - Fitz Partners VfM Board Reporting service (inc. AoV clients' requirements).

From the discussions we have had with our clients in the last few months, it is clear that asset managers and their boards must own the inquiry process and will require internal resources and talent to guide and assist boards in their detailed questioning.

This is in no way a “tick box” exercise where the delivery of a dashboard, report or file will satisfy the regulator or boards. Directors will question the value of each product and unit, based on their review and internal teams will be required to provide guidance.

Directors will have to be presented with evidence provided from drilling down into the underlying data, on which they will have to feel comfortable to draw conclusions and ultimately built their Value Assessment Statement.

Given the amount of work we have been doing alongside our clients in preparation for September - there has been no lack of effort in running extra reviews and testing peer group methodologies - there is very little sign of asset managers taking this new piece of regulation lightly.



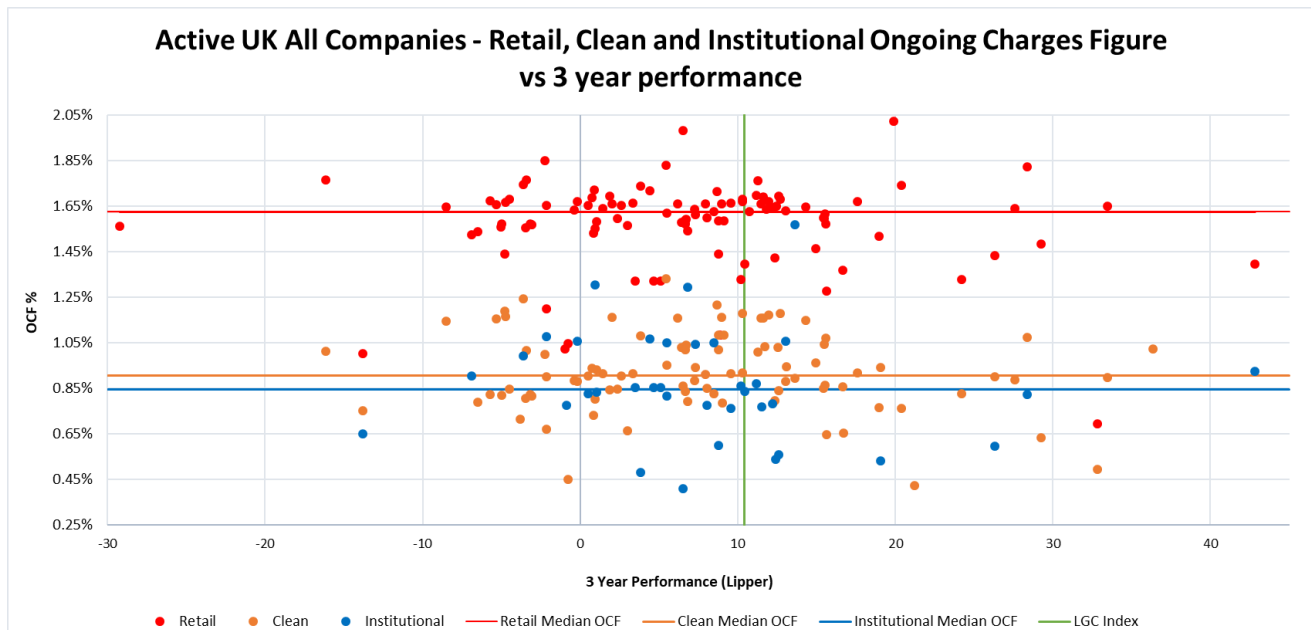
UK Market Overview

In the second part of this report we offer a UK market overview in 5 charts and some comments related to the Assessment of Value process. The charts shown below are not all part of our Board Reporting but are based on the same dataset: Fitz UK Fund Charges database.

Charts:

- Treat Your Customer Fairly (Retail vs Clean vs Institutional)
- Measuring Fund Manufacturers' Costs (OCF)
- The Other Fund Costs (ex-OCF)
- Distribution of Service Charges (Administration & Custody Charges)
- Measuring Economies of Scale (Service Charge)

A. Treat Your Customer Fairly (Retail vs Clean vs Institutional)



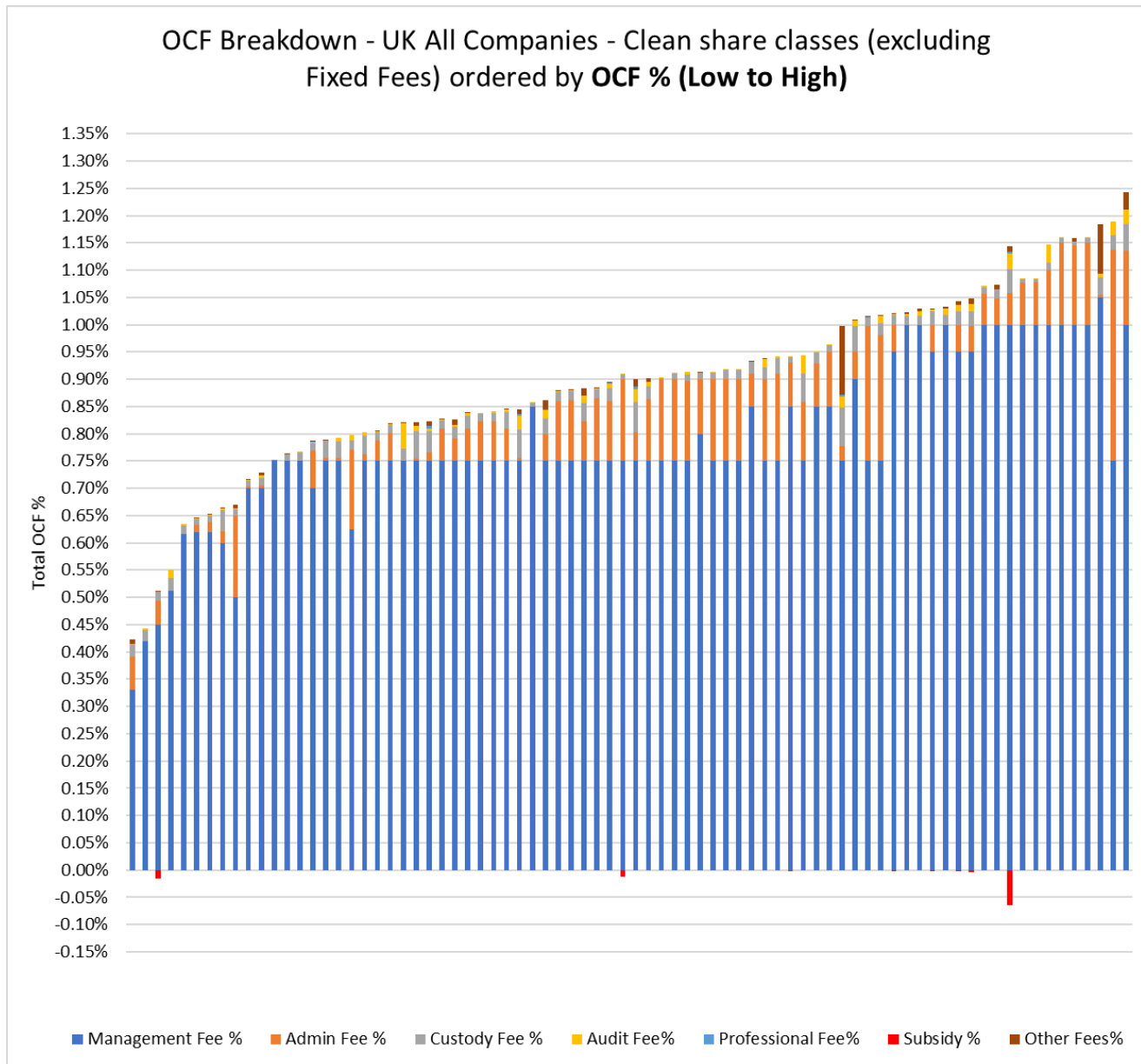
As expected, it is clear from this chart that the level of fees for (legacy, pre-RDR) Retail classes is well above those of Clean and Institutional share classes. On the other hand, the levels of average OCF for Clean classes or Institutional classes are getting very close together and could be evidence of fairness in the pricing of Clean classes targeted at retail investors, at least outside investors platform or access costs.

AoV related investigations:

- How different are the fee structures within one fund product?
- Is this difference acceptable?
- What are the main drivers justifying a difference in fee levels?
- Could “one fee fits all” be a workable alternative?

Value is not easily measured and fund costs are only one variable, but one which can be in part controlled and engineered. The following charts demonstrate the wide variety of structures and fee levels that exist in active Clean share classes belonging to The IA UK All Companies sector and all the fee components that could be reviewed and might be acted upon.

B. Measure Fund manufacturers' costs (OCF)

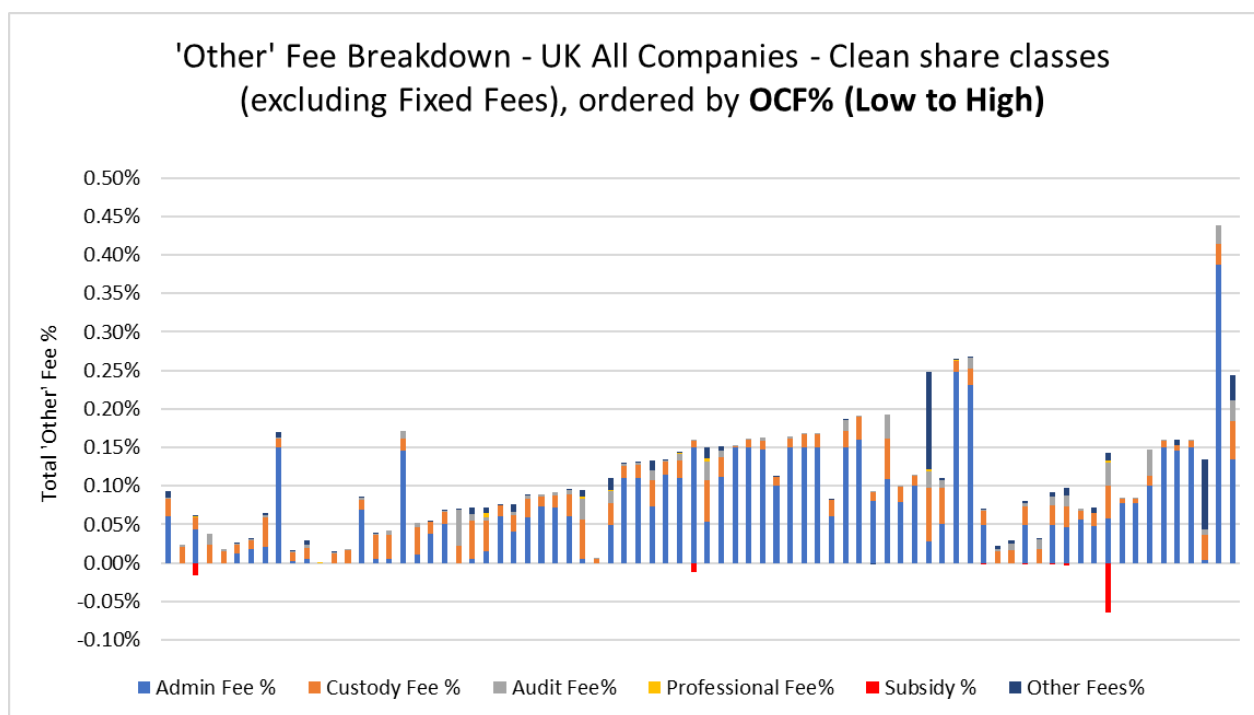


UK All Companies is the largest IA category and representative of the wide variety of OCF levels that are on offer when considering only active funds. There is a concentration of management fees around the 75bps mark but the OCFs remain varied in size, as do their levels of fee components.

AoV related investigations:

- Management fees remain the largest costs of operations, is it optimum?
- What are the business constraints regarding the level of management fees?
- How do peers achieve their own level of OCF?
- Is 75bps a commercial rate?

C. Other Fund Costs (ex-OCF)

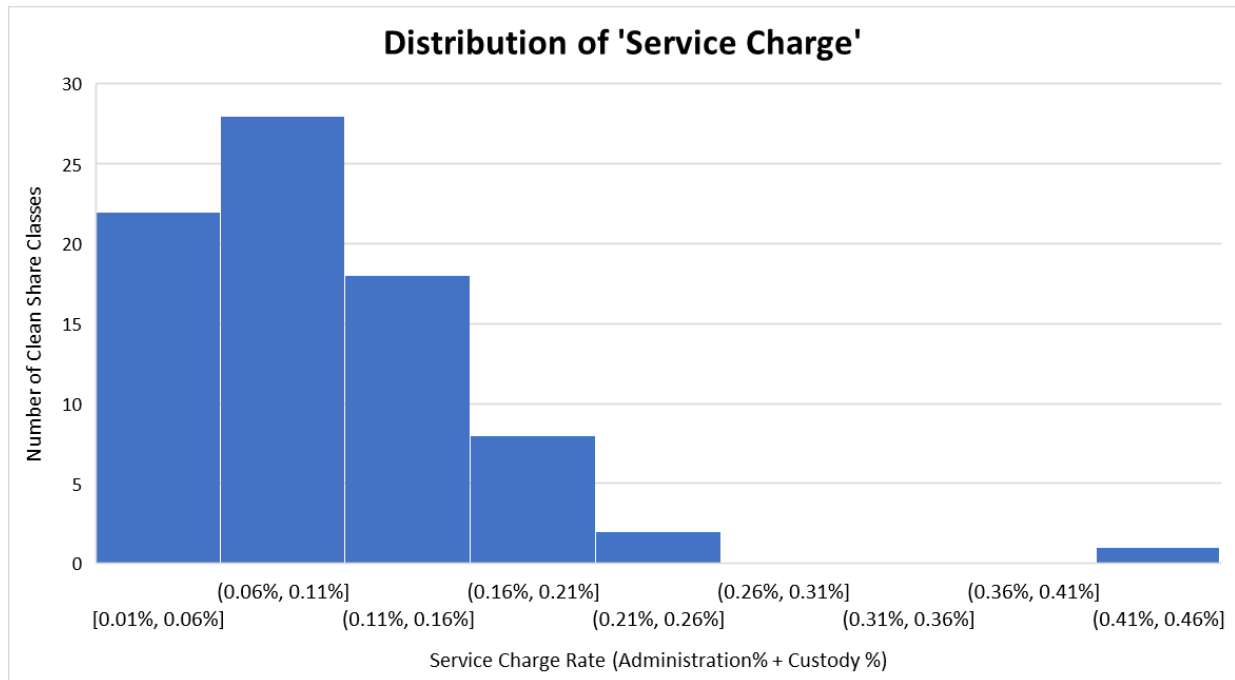


The vast variety of “other costs” (fee components charged outside the management fee) ranked by OCF level is telling. Not all funds with high “Other” fee components have highest OCF and vice versa. The levels of these other costs can result in very diverse levels of OCF. A detailed review of the fee components must help measure a share class positioning against others and find potential scope for improvement.

AoV related investigations:

- How do we compare in terms of costs outside the management fee?
- Where do the differences come from?
- What are the market rates for each of these costs?
- Is there scope for improvement?

D. Service Charges (Administration & Custody Charges)

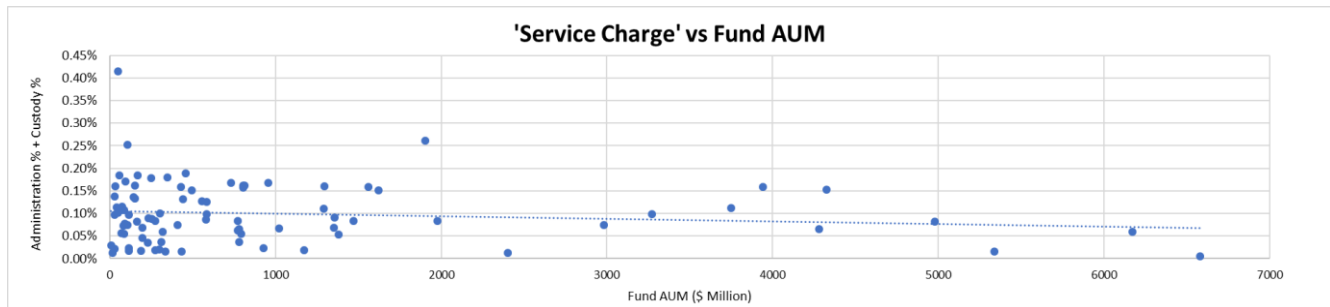


The distribution of “Service Charges” (Administration & Custody fees) shows concentration towards the bottom end of the fees. The spread of the fees themselves is narrow, most of the fees fall between 0 and 16bps with the largest concentration of fees between 6 and 11bps.

AoV related investigations:

- Where do our Service fees stand compared to our peers?
- What is the market rate when it comes to Service fees?
- Do we get value for money from these service providers?
- Is there scope for external service contract negotiations?
- What is the optimum business model (in-house vs external administration)?
- What is the optimum fee structure (fixed fees vs ad valorem)?

E. Economies of Scale (Service Charge)



There are some visible economies of scale when it comes to “Service Charges” (administration & custody). Still some fee levels are disparate and fluctuate from one fund to another and some funds do not seem to deliver any economies of scale at all.

NB: When comparing the same fee levels across fund complex or share class size, the average trend remains very similar.

AoV related investigations:

- Do our Service fees reflect economies of scale?
- Should we introduce breakpoints?
- How do we compare in terms of breakpoint levels?
- Can we redefine or renegotiate breakpoint levels?



FITZ Partners main focus is to support the European funds industry participants in their cost management efforts and fiduciary responsibilities.

FITZ Partners aim to assist asset managers with a regular delivery of consistent and detailed fund expense calculations and fee benchmarks, allowing fund operators and their boards to conduct detailed accurate reviews of funds operating costs.

FITZ Partners offers customised Board Reports and fee review analysis to asset managers, allowing a detailed independent review of the funds share classes on cost and performance. FITZ Partners handles the full fee review and benchmarking process from peer group construction to the publishing of high quality PDF reports directed at fund directors or fee committees. The thorough fee review can be customised but would contain detailed benchmarking of each of the client's share classes across a choice of fund fee components relative to a selected peer group as well as a sub-peer group restricted by fund product size. Other FITZ Partners unique fee categories can also be used in the peer group construction (performance fee, fee caps, minimum investment etc...).

Fitz Board Reports are intended to allow fund boards and fee committees to review, in one place, all relevant share classes using a consistent methodology and relatively position products on value through fee and fund performance quartile indicators, percentile rankings and charts.

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