Costs, Fees and Trustee Decision-Making

Research partnership between Aon and Leeds University Business School

UNIVERSITY OF LEEDS
Leeds University Business School

Aon

Background

Aon is committed to supporting trustees to achieve the right outcomes for their pension schemes.

With this in mind, one of the areas we are currently focussing on is the highly topical and interesting subject of behavioural finance. Specifically, we are looking at how behavioural biases can affect the way in which defined benefit (DB) pension scheme trustees make decisions about their scheme investments.

As a first step, we partnered with Behave London to develop **The Aon Trustee Checklist**, a practical tool designed to reduce decision-making bias in trustee meetings.

Later, we partnered with **Leeds University Business School** (LUBS) to undertake the first major piece of academic research exploring trustee investment decision-making, including perceptions and understanding of costs and value, investment risk and return, manager selection and the role of bias in all of these areas.

Dr Iain Clacher led the research, working with Dr Richard Edgar Hodgett, a lecturer in Business Analytics and Decision Science at LUBS, and Dr Simon McNair, Leverhulme Early Career Research Fellow based at the LUBS Centre for Decision Research. Dr Clacher is currently Associate Professor in Accounting and Finance at Leeds University Business School and is the co-director of the Centre for Advance Studies in Finance. More information about our research partner, including team biographies, can be found on page 15.

In the second half of 2016, we conducted several email and social media campaigns, inviting trustees to participate in the research. 197 responded and completed an online survey, designed by the research team. Additionally, Dr Clacher conducted 10 semi-structured interviews with representatives of a range of pension schemes.

This is the second in a series of reports analysing the research findings, which set out to map the trustee landscape and provide deeper analysis on trustees' perceptions of costs and value, investment risk and return as well as manager selection.

If you have any questions about this research, and to pre-register for future reports, please contact one of the team. Their details can be found at the end of this report.

*All percentage figures stated throughout are presented to the nearest integer.

Introduction

This paper is the second in the series analysing trustees of UK defined benefit pension schemes and examines the extent to which trustees understand costs and fees in fund management. The results of the first paper, *Mapping the Trustee Landscape*[1], found that trustees were highly educated, and had a range of professional qualifications. In addition, a majority of trustees exhibited a high degree of financial literacy when faced with questions on core concepts in investment and finance, such as time value of money, compounding, and inflation. However, the results of the first paper also showed that trustee boards lacked both age and gender diversity, which may not be optimal in making decisions. Moreover, homogeneity on trustee boards is an environment where groupthink may be present, and so an awareness of this may help to mitigate the risk of groupthink dominating decision-making.

The second paper looks in more detail at the salience of costs and fees with respect to investment decision-making, and considers both the explicit and implicit costs and fees associated with fund management.[2]

The separation out of costs and fees into these groups is important in light of the interim report of the Financial Conduct Authority's *Asset Management Market Study*[3], as one of the potential solutions to opacity in the fund management industry is increased disclosure of what many argue are the hidden costs of fund management. If this is to be the solution from the Financial Conduct Authority[4], then it is crucial to understand whether trustees are in a position to actually take any enhanced disclosure and use it meaningfully when making investment decisions for the funds that they steward.

It is also worth noting that any solution may have unintended consequences. For example, a full disclosure of implicit costs and fees may result in information overload and prevent effective decision-making. Similarly, there may be a fixation on 'costs' over 'value' and it is the combination of both that is crucial to effective investment in pension fund management.

Dr Iain Clacher,
Leeds University Business School

Associate Professor in Accounting and Finance
Deputy Director of the Centre for Advanced Studies in Finance (CASIF)
+44 (0)113 343 6860
i.clacher@lubs.leeds.ac.uk

Key results show:

- Interviews with trustees highlight that investment strategy is their primary concern with costs and fees being a second order consideration;
- Almost half of trustees choose active over passive management;
- Trustees have a longer-term focus;
- The influence of investment consultant recommendation was not as strong as expected;
- Trustees are generally good at understanding explicit net of fees analyses, although trustees of smaller schemes did not perform as well;
- Trustees in general are less familiar with implicit fees, and this is worse for trustees of small schemes;
- All trustees, and especially the trustees of smaller schemes, will need to be better supported in a world where the implicit costs of fund management are part of the decision-making criteria for trustees.

[1] http://www.aon.com/unitedkingdom/retirement-investment/investment/mapping-the-trustee-landscape.jsp
[2] When we separate costs and fees into explicit costs this refers to the Total Expense Ratio while implicit costs and fees refers to other costs associated with fund management such as custodian fees, exchange fees, bid-ask spread etc.
[3] https://www.fca.org.uk/publications/market-studies/asset-management-market-study
[4] It is worth noting that the FCA has proposed a single "all in" figure, which may only add to opacity of costs and fees so while a 'larger' fee is visible, what drives this fee may not be understood.

Costs and fees – the trustee perspective

As part of the investigation into trustee decision-making, a number of trustees from a range of different pension schemes were interviewed to gain perspectives across a range of issues, including the role of costs and fees in investment management. Specifically, trustees were asked *'How important do you see costs and fees being in your investment decision-making, and what sort of discussions do you have around this?'* Below is a range of responses that are reflective of the broader views that emerged through the interview process.

Across the comments, there is a general view that costs and fees are not the key to pension fund outcomes; for trustees this is achieved via strategy and asset allocation, and it is this that is their primary focus.

> "Costs and fees aren't hugely prominent in governing a decision. As a strategy develops, we will undertake periodic review from a risk management perspective to see how much money is going to one firm. We then ask whether there is value to be gained from further consolidation or is there value to be gained in a broader perspective through smaller mandates?"
>
> Chairman, Trustee Board

> "Costs and fees don't drive what we are doing. If we look at a new asset class we ask, why are we considering this, how does it fit with our strategy, what do our investment consultants say, what is the performance of the asset manager net of fees, are we confident about this performance? Costs and fees are a second order concern and strategy comes first."
>
> Chair of Investment Committee,
> Large Defined Benefit Scheme

Similarly, there was a view that it was not a trustee's job to concern themselves with fees, as this should have been taken account of in the selection of the fund managers.

> "Costs and fees are not high up the list. Our focus is net of fees not gross of fees. Fees are the remit of the consultant as part of their due diligence."
>
> Independent Trustee, Small to Mid-size Schemes

However, there was also a view that it is about knowing what you are paying for and how any value that additional fees generates is split between the pension fund and the fund manager. Such an approach is consistent with notions of value for money and how any gains are shared.

> "Our focus is on asset allocation. Our philosophy on fees is how much excess return goes to the asset manager and how much goes to the pension fund? Costs and fees are clearly important but they are not the be all and end all of this. When investments are being made you have to go into them with open eyes, so if you are paying high fees you have to know what it is you are paying for."
>
> CIO, Large Pension Fund

There was also the view that the costs and fees issue has been overstated, although this was not a common view. Underpinning this view is the fact that investment managers often hide behind complexity and the issue is one of leakage.[5] As such, were leakage to be better managed then the cost and fees issue would be less prominent.

> "There is a lot of bluff about this. There are three or four managers out there who compete to keep their costs low to maintain their benchmark. Active managers would do better if they could keep leakage down. Leakage goes against fiduciary duty as it's other people's money. Investment managers hide behind the complex bits."
>
> Director, Firm of Independent Trustees

[5] Leakage here refers to a loss of value to the pension fund through higher costs within a fund that are necessary.

Choosing investments

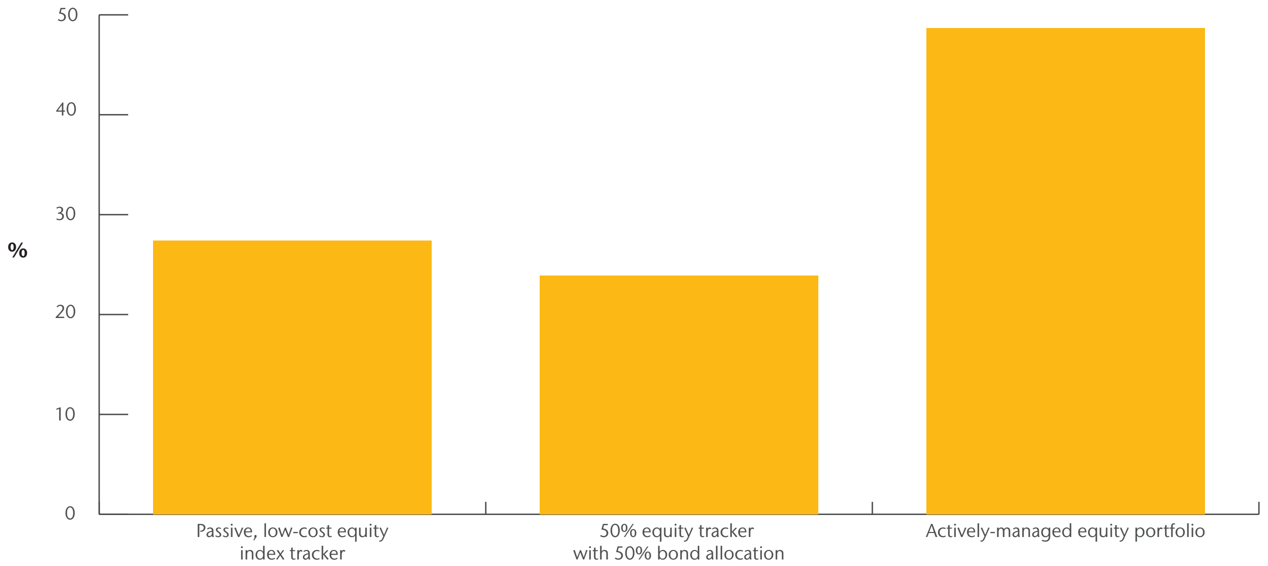
The second part of our analysis for this paper was conducted via an online survey, which has generated data across a range of issues based on the responses of 197 trustees, who represent a range of scheme sizes and trustee types.[6]

Choosing investments from descriptions

The first area examined in the survey offered trustees a simple choice of three different funds with only descriptions of the fund type. Trustees were asked to pick the best investment from a passive, low-cost index tracker, a balanced fund with 50% invested in bonds and 50% in an index tracker, or an actively managed equity portfolio. From Figure 1, almost 49% of the sample picked the actively-managed equity portfolio, with around 27% and 24% picking the index tracker, and balanced fund respectively.

This first result is interesting, as nearly 50% of trustees picked the actively-managed fund and it is actively-managed funds, and the costs and fees associated with such funds, which have been singled out as opaque and in many instances too high relative to the returns generated. The ability of active managers to beat the market and pick stocks has long been researched in academia, and although there are papers that show instances where active managers have outperformed, the majority of the evidence shows that the average benchmark-adjusted net return for active funds is approximately zero (Cremers, et al, 2016).

Figure 1 – Choose the best investment



In looking at the fund management industry, there is a significant amount of investment in the marketing of active fund management and the value of active fund management. Underpinning this is the belief that managers can beat the market on a systematic basis and in doing so add value over and above a low cost tracker that merely follows the index.[7] As with the average outperformance evidence cited above, there is considerable long-run evidence that the market cannot be systematically beaten after costs and fees. *'A Random Walk down Wall St.'* for example looks at the top performing fund managers over a five year period and is updated over the next five years and the most telling result is that those managers who are at the top in one period are rarely at the top in the next.[8]

However, the active fund management debate is not as clear-cut. There is evidence that factor-based investing strategies, which are often described as Smart Beta strategies, can outperform. One of the longest-lived strategies in this area is the Fama-French 3 Factor Model (1993), which shows that investing in value[9] and small-cap stocks outperforms the market on a regular basis. Similarly, the Carhart (1997) model extends the Fama-French 3 Factor model to include momentum,[10] and this is also found to explain returns in the long-run and so a strategy of buying winners and selling losers is an active strategy that beats the market.[11]

[6] For more detail about the make-up of our sample of trustees see, http://www.aon.com/unitedkingdom/retirement-investment/investment/mapping-the-trustee-landscape.jsp
[7] For an insightful critique of this issue see Robin Powell's submission to the FCA which can be found at, http://www.evidenceinvestor.co.uk/tebis-response-to-the-fca-report/
[8] *'A Random Walk down Wall St.'* by Burton Malkiel is now in its 11th edition with the first being published in 1973
[9] Value stocks are those that tend to trade at lower value than the company fundamentals would imply, while growth stocks are those where the earnings of the firm are expected to increase at a rate above earnings growth in the market.
[10] Momentum here refers to shares that have either an upwards or downwards trend and trading is done based on buying those stocks that are increasing and selling those stocks that are decreasing.
[11] It is worth noting that the proliferation of Smart Beta funds in recent years has resulted in a huge number of funds that suggest they have identified 'additional' factors, however, this in many instances may be data mining and whether the identified factors hold in the long-run is a major concern. See, Finding Smart Beta in the Factor Zoo, Jason Hsu, Vitali Kalesnik (2014) for a discussion of this.

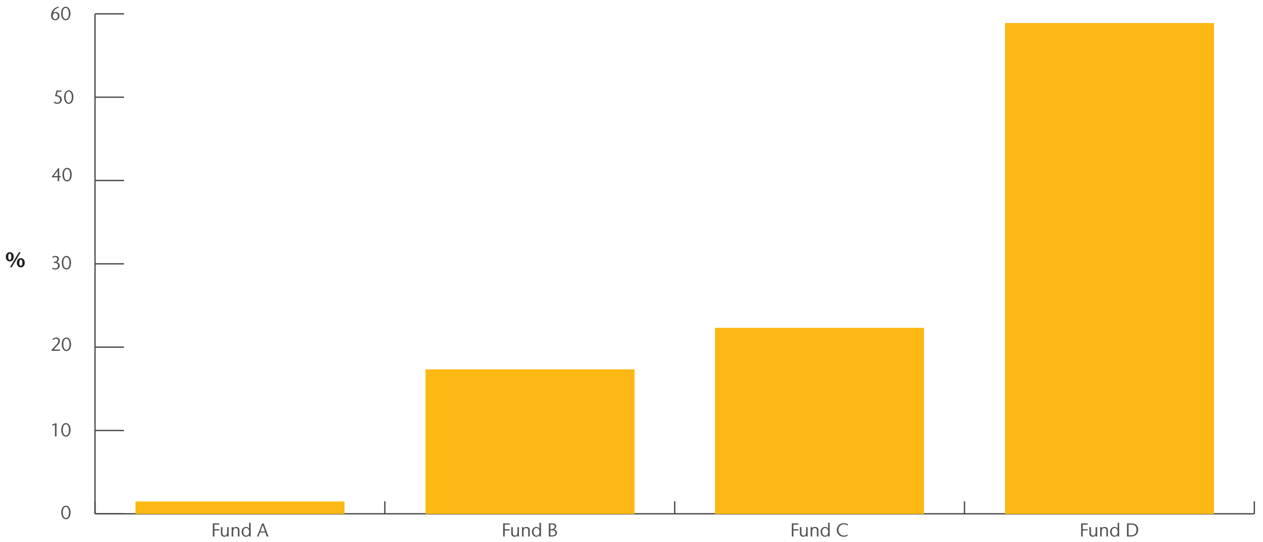
Given the conflicting evidence about active vs passive management the question then becomes one of *'why do investors not benefit from the gains that are apparent.'* In looking at this objectively, there are two main reasons. First, is volatility and risk; an active strategy such as momentum trading requires a high level of commitment to the strategy. Consequently, the volatility around such an approach may not be something that a trustee or pension fund can tolerate over the time-frame required to make the strategy work, which will be particularly true when losses are being incurred. Second, is cost; in many instances the gains from active management are absorbed by the fee structures and so the benefits of such strategies accrue to the fund manager rather than the pension fund. There is a case to be made that the debate should move away from active vs passive management, and be one of low-cost vs high-cost fund management.[12]

One final thing about selecting an active fund manager is that it means someone is picking the investments rather than just passively holding an index. The combination of marketing from the industry, the desire for outperformance, and the knowledge that someone is selecting where pension fund assets are being invested and monitoring etc. may explain why this choice was made based on no other evidence than the type of fund.

Choosing investments from performance information

Next trustees were asked to pick the best fund based on historical performance information about the funds. Here trustees were given information on the one-year, three-year, and five-year performance of the funds, as well as the benchmark returns, and all of these funds were described as being actively managed. From Figure 2, almost 59% of trustees picked Fund D, which had the best performance over the five-year period and outperformed the benchmark by the greatest margin. Fund C was selected by approximately 22% of trustees, which had the most stable performance over the one, three, and five-year periods. In designing the question, Fund A was presented to give the highest return over a one-year period, and was included to assess if short-termism was present. From Figure 2 it can be seen that only three trustees out of 197 (1.5%) picked this fund and while only a high-level analysis, this suggests that myopia is not a significant driver in our sample of trustees.

Figure 2 – Choose the equity fund that you think is the best investment on a returns basis



	Fund A Active FTSE All Share (UK) Equity Fund	**Fund B** Active FTSE All Share (UK) Equity Fund	**Fund C** Active FTSE All Share (UK) Equity Fund	**Fund D** Active FTSE All Share (UK) Equity Fund	**Benchmark**
1-yr gross return (%)	7.2%	1.0%	6.6%	-3.3%	1.0%
3-yr gross return (% p.a.)	5.8%	9.0%	6.2%	7.8%	7.3%
5-yr gross return (% p.a.)	0.7%	6.7%	5.8%	9.2%	5.8%

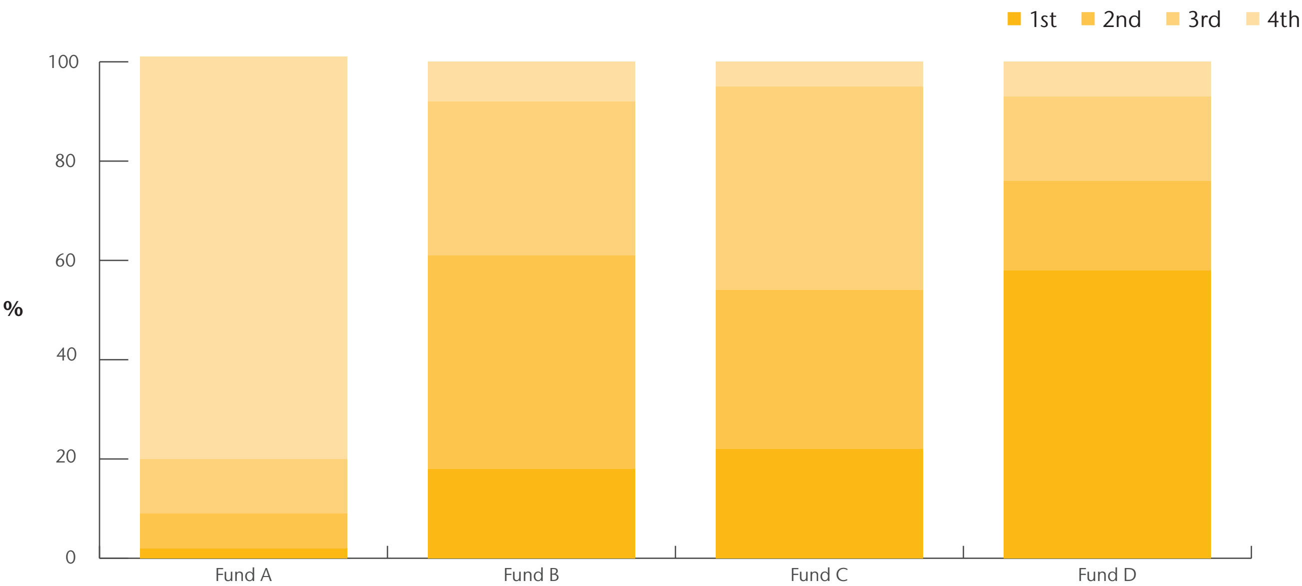
[12] The re-framing of active vs passive debate as high-cost vs low-cost comes from discussions with John Belgrove who first suggested this way of looking at the issue as it is not about active vs passive per se, it is about high-cost vs low-cost investment.

Choosing investments from consultant recommendations

Next we examined the impact of investment consultant recommendation and presented trustees with the same information on the performance and benchmark of funds A-D, but added in an investment consultant recommendation. The recommendation was also explained within the question as, *'The investment consultant's performance outlook should be interpreted as a forward-looking view on the manager's ability to outperform the benchmark over the long-term.'*

In looking at Figure 3, 58% of the sample ranked Fund D as the best once the consultant's recommendation is included. In looking into the data underpinning Figures 2 and 3, of those who selected Fund D without the investment consultant's recommendation (100 trustees), 87 trustees remained with Fund D and ranked it number one once the investment consultants recommendation was included. However, while 13 trustees moved away from Fund D, an extra 29 trustees (15%) did chose it as their top ranked fund once the consultant recommendation was revealed. From the data in Figure 3, it seems, at least in this test, that the investment consultant recommendation did not sway large numbers of respondents towards a particular fund and although some movement was present, it did not result in a wholesale reappraisal by all trustees.[13]

Figure 3 – Investment consultant's recommendation



	Fund A Active FTSE All Share (UK) Equity Fund	Fund B Active FTSE All Share (UK) Equity Fund	Fund C Active FTSE All Share (UK) Equity Fund	Fund D Active FTSE All Share (UK) Equity Fund	Benchmark
1-yr gross return (%)	7.2%	1.0%	6.6%	-3.3%	1.0%
3-yr gross return (% p.a.)	5.8%	9.0%	6.2%	7.8%	7.3%
5-yr gross return (% p.a.)	0.7%	6.7%	5.8%	9.2%	5.8%
Investment consultant's performance outlook	Average	Average	Above average	Strong	n/a

[13] In such a stylised test, there is a risk of over-interpreting the result and so it is not possible to report more on what drives the individual trustees to switch or remain, without directly speaking to respondents, and that is not possible. Moreover, those who remain with their original choice may be exhibiting confirmation bias, while those who do not switch may be exhibiting over confidence.

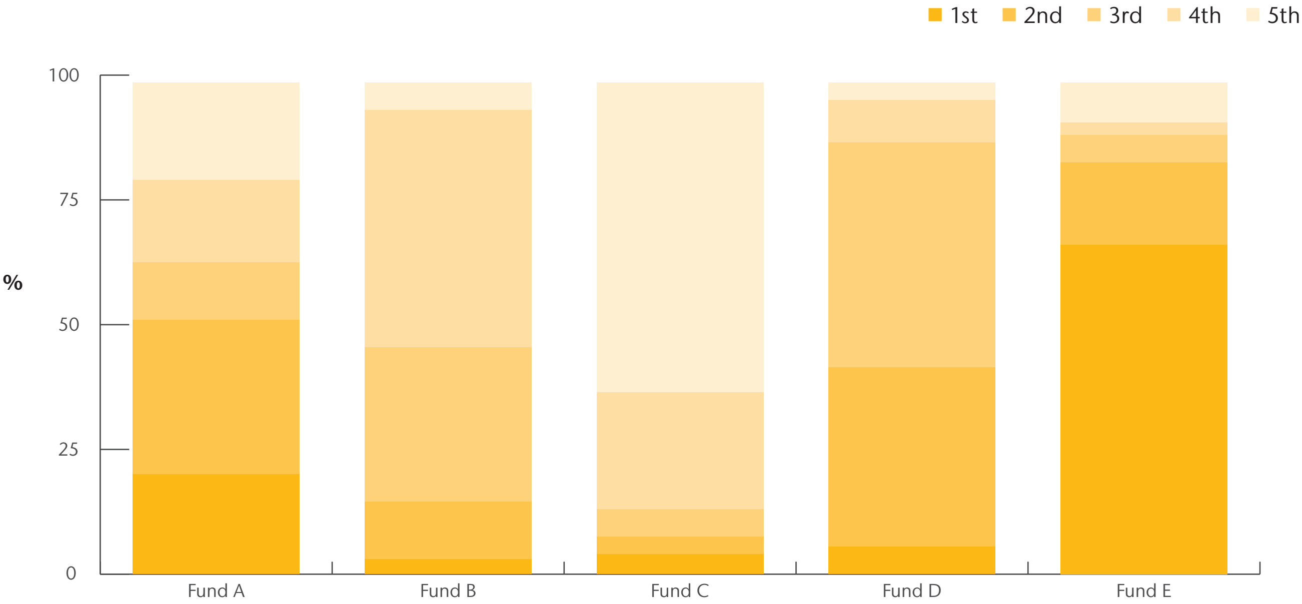
Choosing investments with assets under management

The next test looked at whether assets under management influenced the choices that trustees make. Trustees were offered a choice of five funds, and each fund had five-year gross returns and the assets under management (AUM) of each fund presented. In setting the question, both Fund A and Fund E had the same gross return of 6.8% but differed in assets under management, with Fund E having a hypothetical £20.2bn AUM and Fund A having £55m.

In looking at the rankings of the funds, the vast majority ranked Fund E as being number one followed by Fund A. This is an interesting result, as there is considerable evidence from academia and other research to show that fund size destroys value ie, the larger the active fund the more difficult it is to achieve outperformance.[14] Moreover, large funds have economies of scale but often charge similar fees to smaller funds. In addition, this may also indicate reluctance on the part of trustees to invest in emerging funds.

Figure 4 – Assets under management

Please rank the funds below from 1 to 5, starting with the one which you believe to be the best investment, with 1 being the worst and 5 being the best.



	Fund A Active FTSE All Share (UK) Equity Fund	Fund B Active FTSE All Share (UK) Equity Fund	Fund C Active FTSE All Share (UK) Equity Fund	Fund D Active FTSE All Share (UK) Equity Fund	Fund E Active FTSE All Share (UK) Equity Fund
5-yr gross return (% p.a.)	6.8%	6.0%	5.7%	6.3%	6.8%
Assets under management	£55m	£1.1bn	£525m	£10.3bn	£20.2bn

[14] See for example, Pastor and Stambaugh (2012)

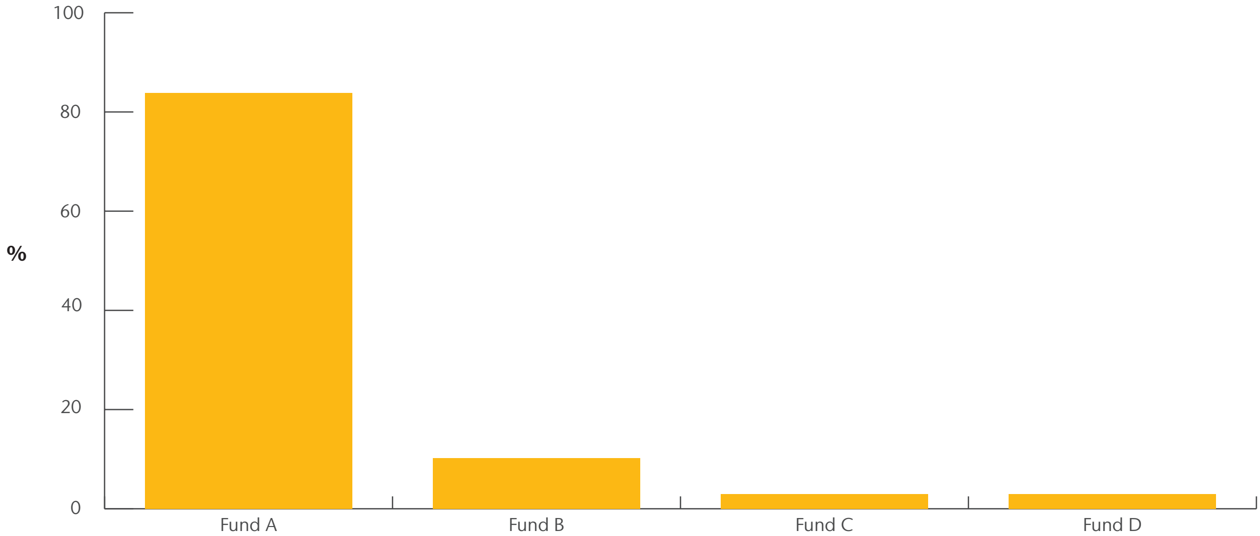
Explicit costs and fees

The next set of questions that trustees were faced with asked them to select investments based on net returns. In setting these questions, trustees were given a range of funds that they could select and were presented with gross five-year returns and various cost disclosures including the total expense ratio and components of the total expense ratio. In looking at Figures 5a and 5b, trustees were given gross returns and the total expense ratio in 5a, and the total expense ratio and an annual management charge, which is included in the total expense ratio, and can be viewed as an additional distractor. In behavioural economics, distractors ie, irrelevant information, can lead to poor choices as individuals struggle to process the relevant information[15] and in this setting, it could lower the relevance of costs and fees.

From the results in Figure 5a, 84% of our sample picked the best fund net of fees (Fund A), and while stylised, is indicative that trustees understand the basic net of fees calculation. Although, this also shows that 32 out of 197 trustees did not get this correct. Further examination of those who did not get the basic net of fees calculation correct shows that 18 out of the 32 responses had assets under management of less than £500m.

Figure 5a – Net of fees

From the equity funds described below, choose the fund that you think is the best investment based on a net returns basis.



	Fund A Active FTSE All Share (UK) Equity Fund	Fund B Active FTSE All Share (UK) Equity Fund	Fund C Active FTSE All Share (UK) Equity Fund	Fund D Active FTSE All Share (UK) Equity Fund
5-yr gross return (% p.a.)	4.61%	4.38%	4.58%	4.12%
Total expense ratio (% p.a.)	0.74%	0.62%	0.85%	0.91%

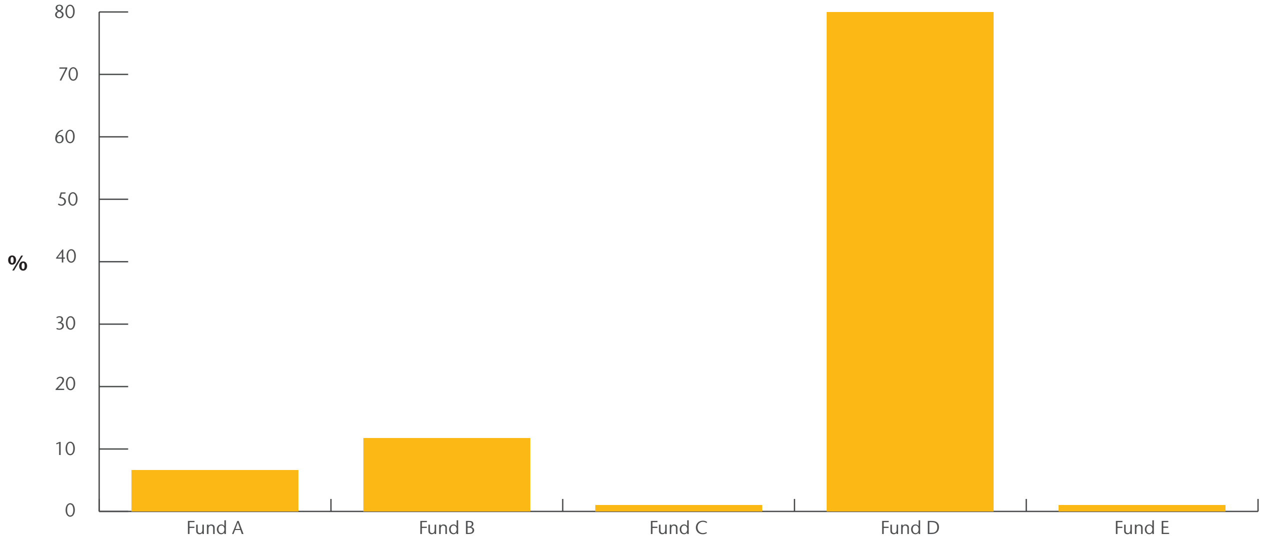
[15] See for example, Bertrand et al. (2010) and Chater, Huck and Inderst (2010

In looking at the results of the second question in Figure 5b, a similar proportion can be seen as picking the correct fund (Fund D). A majority of trustees can, therefore, do the net of fees calculation and select the best fund on that basis. Such a result in and of itself may not be surprising as this is the type of decision that trustees have been faced with in their role. However, to demonstrate this is useful as it adds to the knowledge of what trustees can and cannot do, and builds on the evidence that was presented in our first paper, which included an analysis of the financial literacy of trustees.

That said, there is a small but significant portion of our sample who have not answered the questions correctly. Similar to the results presented in Figure 5a, a majority of those who selected the wrong fund based on net of fees were those where assets under management were smaller. Consequently, while the overall result is reassuring as to the level of competence and understanding in the trustee market, there remain areas of concern regarding smaller pension funds.

Figure 5b – Net of fees

From the equity funds described below, choose the fund that you think is the best investment on a net returns basis.

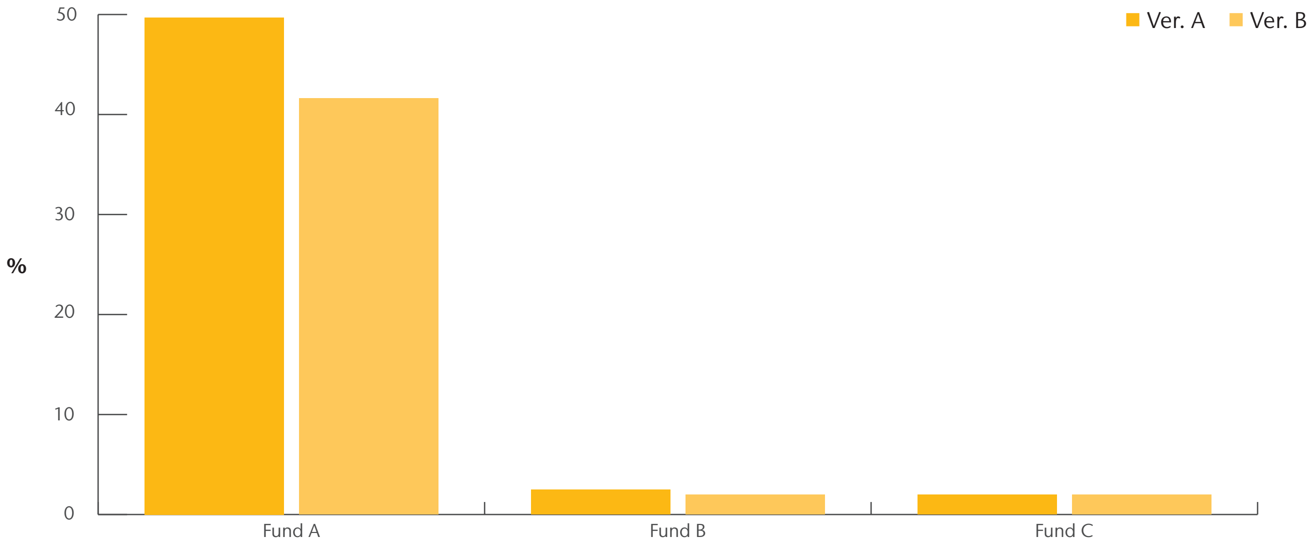


	Fund A Active FTSE All Share (UK) Equity Fund	**Fund B** Active FTSE All Share (UK) Equity Fund	**Fund C** Active FTSE All Share (UK) Equity Fund	**Fund D** Active FTSE All Share (UK) Equity Fund	**Fund E** Active FTSE All Share (UK) Equity Fund
5-yr gross return (% p.a.)	6.8%	6.0%	5.7%	6.3%	5.7%
Annual management charge (% p.a.)	0.7%	0.2%	0.9%	0.3%	0.4%
Total expense ratio (% p.a.)	0.9%	0.2%	1.0%	0.3%	0.5%

The final two sets of questions on explicit costs and fees present a much more granular level of fee disclosure. Trustees were asked to pick what they viewed as the best fund. In setting these questions, two versions were created for each to ensure that ordering bias was not present in our questioning. As a result, the positioning of the Total Expense Ratio was moved to the first line of costs in one version and was the final line in the second. In looking at Figure 6a, approximately 90% of respondents picked Fund A, which was the best fund on both a gross and net returns basis, and so the slight increase in the ability of trustees to select the correct fund is because there was no explicit direction given.

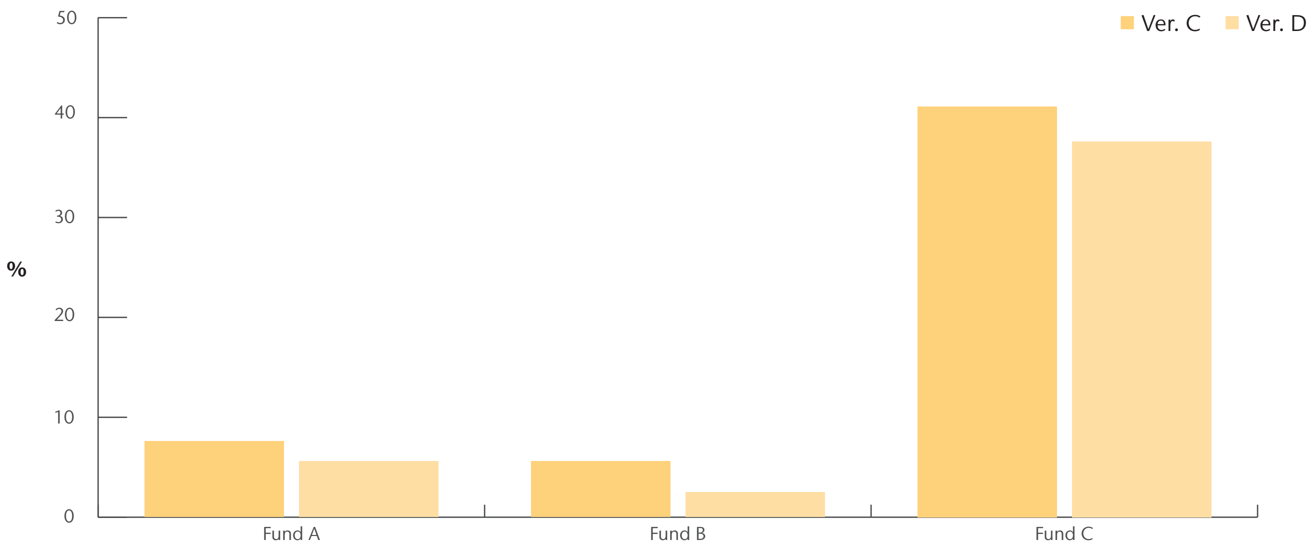
From Figure 6b, a similar approach to the setting of the question was taken but with additional information on the fund assets under management. From the results in 6b, it can be seen that approximately 78% of trustees selected Fund C, which was the best fund on both a net and gross basis. In examining those funds that selected Fund A or Fund B, the data shows that these funds were picked by larger schemes, with schemes with assets under management of £2.5bn – £5bn and £5bn+ being the largest groups. Larger funds may, therefore, be drawn towards the larger funds given their relative size.

Figure 6a – Pick the best investment



	Fund A Active FTSE All Share (UK) Equity Fund	Fund B Active FTSE All Share (UK) Equity Fund	Fund C Active FTSE All Share (UK) Equity Fund
5-yr gross return (% p.a.)	4.61%	4.18%	4.28%
Annual management charge (% p.a.)	0.25%	0.40%	0.55%
Distribution fees (% p.a.)	None	0.15%	None
Other expenses (% p.a.)	0.28%	0.18%	0.22%
Total expense ratio (% p.a.)	0.53%	0.73%	0.77%

Figure 6b – Pick the best investment



	Fund A Active FTSE All Share (UK) Equity Fund	Fund B Active FTSE All Share (UK) Equity Fund	Fund C Active FTSE All Share (UK) Equity Fund
5-yr return (% p.a.)	4.17%	4.07%	4.50%
Assets under management	£10bn	£2.1bn	£0.8bn
Annual management charge (% p.a.)	0.52%	0.37%	0.22%
Distribution fees (% p.a.)	None	0.12%	None
Other expenses (% p.a.)	0.19%	0.15%	0.25%
Total expense ratio (% p.a.)	0.71%	0.64%	0.47%

Implicit costs and fees

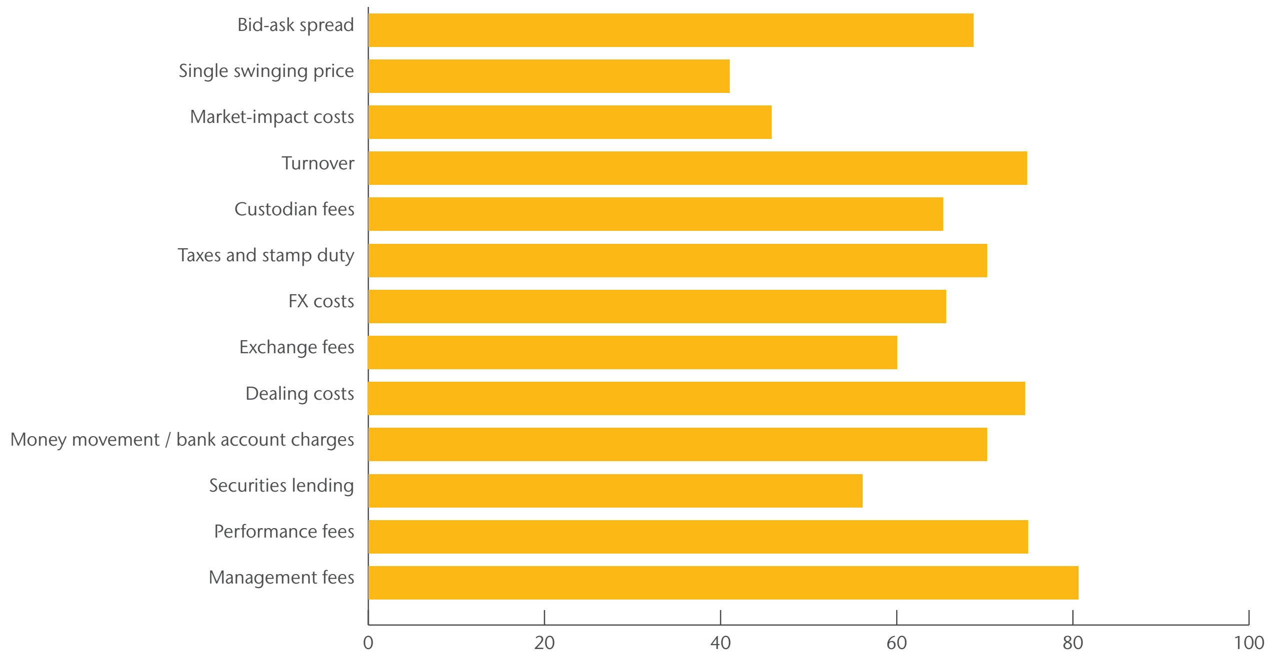
The final part of our analysis into costs and fees looks at implicit rather than explicit costs and fees. In setting a question on implicit costs and fees, it is a question of how best to do this. The approach that has been taken is to select a range of implicit costs and fees and ask trustees to rank how familiar they are with each term.[16] Some of these costs are the subject of much debate within the industry, as they arguably cannot be known with certainty eg, market impact costs. However, they can still lead to a cost being incurred by a pension fund. In setting this question the issue is, therefore, not about the practicalities of whether a cost is sensible or practical etc. but about understanding whether trustees have any awareness of implicit costs and fees broadly defined. This is important, as it is likely that understanding implicit costs and fees is going to something that is expected of trustees in the future.[17]

As part of the survey, trustees were asked, 'How familiar are you with the following terms in fund management?' and Figures 7a and 7b show trustees' self-rated familiarity with a range of implicit costs and fees.[18] Figure 7a presents this for the whole sample while Figure 7b presents this for schemes with assets under £100m.

From Figure 7a, it is clear that compared to explicit costs and fees ie, performance fees and management fees, which are the bottom two bars on the figure, there is a lower level of familiarity with implicit costs and fees in general. Moreover, securities lending, market impact costs, and single swinging price, are the least familiar. However, in looking at Figure 7b, the level of familiarity across almost all fees becomes lower, with trustees of smaller schemes showing a lower level of familiarity with both explicit costs ie, management and performance fees (the bottom two bars of Figure 7b) and almost all implicit costs, including less esoteric costs eg, custodian fees.

Overall, these results suggest that trustees, and in particular trustees of smaller schemes, will have to be supported to enable them to process and use this information in effective decision-making.

Figure 7a – Implicit costs and fees – full sample

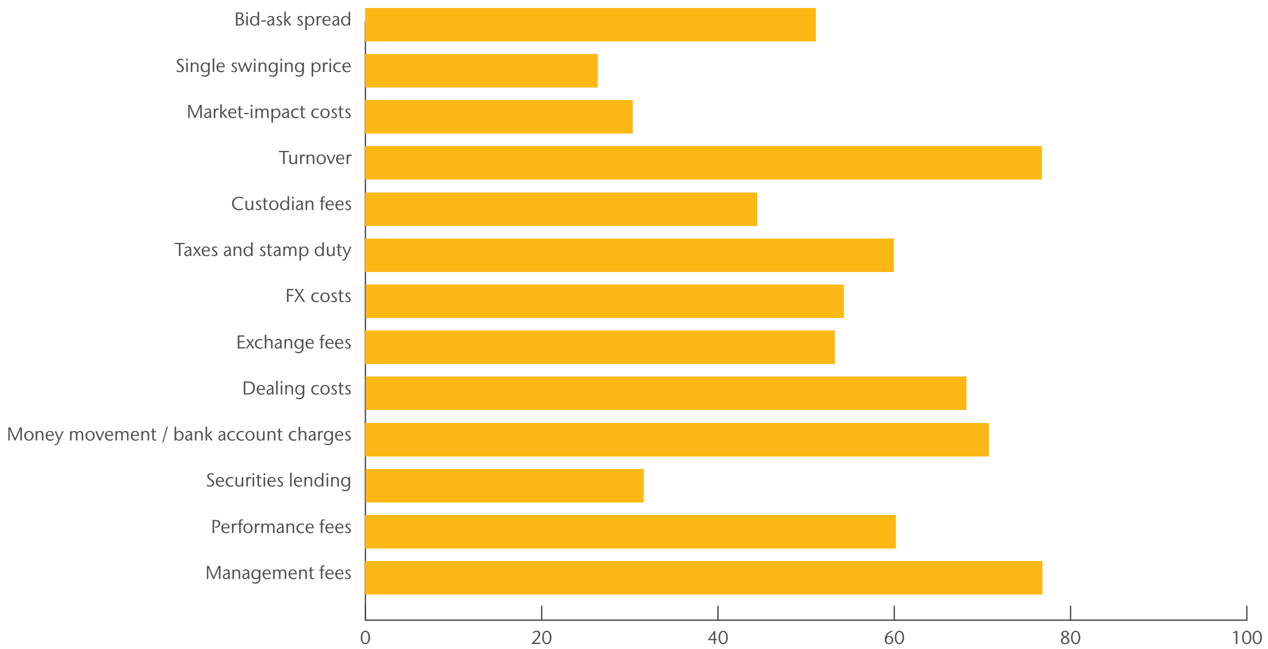


[16] In looking at generating a list of implicit costs and fees, the Transparency Taskforce has generated a list of over 300 costs that are incurred in fund management. For the sake of this report we have picked a range of these that we expect to have some public understanding eg, Foreign Exchange Costs and those that are less likely to be familiar eg, Market Impact Costs. However, it is worth noting that Market Impact Costs appeared in the consumer magazine ***Which*** in November 2016 as cost that investors should be concerned about. See, Whittled Away, Michael Trudeau, *Which*, November 2016.

[17] It is worth mentioning that net of costs and fees performance is what matters. However, if there are higher costs going on inside a fund than are necessary and these are being passed on to a pension scheme, then this leakage benefits the fund manager at the cost of the fund. The ability to see and understand these implicit costs is what is likely to help drive value for money and prevent such leakage in the future.

[18] Trustees were asked to rank their familiarity with each term on a scale of 0–100 with 0 being 'I have never heard of it' and 100 being 'very familiar'.

Figure 7b – Implicit costs and fees – small schemes (AUM<£100m)



Summary

This paper is the second in the series analysing trustees of UK defined benefit pension schemes and examines the extent to which trustees understand costs and fees in fund management. From a behavioural standpoint, the issue is on the relevance of costs and fees in fund management. Specifically, the paper aims to understand the issues faced by trustees concerning both the explicit and implicit costs and fees associated with fund management.

The key results show that trustees are generally good at understanding explicit net of fees questions, although trustees of smaller schemes did not perform as well. Moreover, trustees are in general less familiar with implicit fees, and this is particularly true for trustees of smaller schemes.

Although almost half of trustees would choose active over passive management, trustees do have a longer-term focus. Moreover, the influence of investment consultant recommendation was not as strong as many might have expected.

Interestingly, from a range of interviews with trustees, it is investment strategy that is their primary concern, with costs and fees being a second order consideration.

In looking at the direction of travel with respect to the Financial Conduct Authority's *Asset Management Market Study*, the likely outcome is one with an increased emphasis on the implicit costs and fees in fund management. Trustees, and especially the trustees of smaller schemes, will need to be better supported in a world where the implicit costs of fund management are part of the decision-making criteria for trustees in the future.

Our key results are as follows:

- Interviews with trustees highlight that investment strategy is their primary concern with costs and fees being a second order consideration;
- Almost half of trustees choose active over passive management;
- Trustees have a longer-term focus;
- The influence of investment consultant recommendation was not as strong as many might expected;
- Trustees are generally good at understanding explicit net of fees analyses, although trustees of smaller schemes did not perform as well;
- Trustees in general are less familiar with implicit fees, and this is particularly true for trustees of smaller schemes;
- All trustees, and especially the trustees of smaller schemes, will need to be better supported in a world where the implicit costs of fund management are part of the decision-making criteria for trustees.

References

Bertrand, M., D. Karlan, S. Mullainathan, E. Shafir, and J. Zinman, (2010). What's Advertising Content Worth? Evidence from a Consumer Credit Marketing Field Experiment, *Quarterly Journal of Economics*, 125 .

Carhart, M.M., (1997). On Persistence in Mutual Fund Performance, *The Journal of Finance*, 52, pp. 57-82. v

Chater, N., S. Huck, and R. Inderst, (2010). Consumer Decision-making in Retail Investment Services, Report to the European Commission (SANCO).

Cremers, M., M. A. Ferreira, P. Matos and L. Starks (2016) Indexing and active fund management: International evidence, *Journal of Financial Economics*, 120, pp. 539-560.

Fama, E.F. and K. R. French, (1993). Common Risk Factors in the Returns on Stocks and Bonds, *Journal of Financial Economics*, 33, pp. 3-56.

Páástor, L. and R. F. Stambaugh, (2012). On the Size of the Active Management Industry, *Journal of Political Economy*, 120, pp. 740-781.

Our research partner

Leeds University Business School

Leeds University Business School is a leading full-service European business school with more than 3000 students from around 100 countries, and more than 200 academic staff. The Business School is a faculty of the University of Leeds, one of the largest higher education institutions in the UK, positioned in the top 100 best universities in the world (QS rankings 2016/17) and a member of the Russell group research-intensive universities. The University of Leeds has been named University of the Year 2017 by The Times and The Sunday Times' Good University Guide.

The Business School is a top ten business and management research institution in the UK, according to the 2014 Research Excellence Framework. In recognition of excellence in research and teaching, the School is proud to hold 'triple accreditation' from the three leading international bodies, AACSB, AMBA and EQUIS. The School regularly appears in the top rankings including the Financial Times and The Economist.

The School holds the Small Business Charter award for its role in engaging with regional businesses, and the University has won three high profile national awards for enterprise and entrepreneurship.

For more information on Leeds University Business School, please visit: business.leeds.ac.uk

Research team

Dr Iain Clacher is currently an Associate Professor in Accounting and Finance at Leeds University Business School and he is the co-director of the Centre for Advanced Studies in Finance. His main research interests focus on: pensions and retirement saving decisions, pension investment and infrastructure, and sustainable pension systems. As well as his academic activities, Iain has a number of external appointments, including involvement in a number of working parties for the UK Actuarial Profession, and he is currently the co-chair of the Profession's cross-practice working party on behavioural economics for actuaries. Iain has also advised a range of organisations including; FTSE 100 Companies, The CERN Pension Fund, The City of London Corporation, The Work Foundation, and The Pensions and Lifetime Savings Association.

Dr. Simon McNair is currently a Leverhulme Early Career Research Fellow based at the Centre for Decision Research at Leeds University Business School. Simon's academic background is in the psychology of judgement and decision-making, with particular focus on how individual differences in cognitive and emotional characteristics affect people's financial behaviour. Simon has produced research with various organisations including Grant Thornton UK LLP, Citizens Advice Bureau, and Suitable Strategies on topics such as developing more effective debt advice policies and procedures; and understanding the psychological components of financial capability.

Dr. Richard Edgar Hodgett is a lecturer in Business Analytics and Decision Science who teaches BSc and MSc students material on data pre-processing, statistics, machine learning, artificial intelligence, big data systems, cloud computing, network graphing, optimisation and forecasting. Richard works on various different multi-disciplinary analytical projects and supervises a number of MSc and PhD students. Before joining the University of Leeds, Richard worked as an Innovation Specialist developing an electronic innovation toolkit that is now used by some of the world's leading industrial companies. Prior to this Richard was awarded his Ph.D. from Newcastle University where he developed a software tool for analysing complex decision problems in whole process design.

Contacts

Aon

John Belgrove, Senior Partner
Consulting | Global Investment Practice
+44 (0)20 7086 9021
john.belgrove@aon.com

Tim Giles, Head of UK Investment Consulting
Consulting | Global Investment Practice
+44 (0)20 7086 9115
tim.giles@aon.com

Lynda Whitney, FIA, Partner
Consulting | Retirement Practice
+44 (0)13 7273 3617
lynda.whitney@aon.com

Leeds University Business School

Dr Iain Clacher,
Associate Professor in Accounting and Finance
Deputy Director of the Centre for Advanced Studies
in Finance (CASIF)
+44 (0)11 3343 6860
i.clacher@lubs.leeds.ac.uk

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.
For further information on our capabilities and to learn how we empower results for clients, please visit http://aon.mediaroom.com.

Aon Hewitt Limited is authorised and regulated by the Financial Conduct Authority. Registered in England & Wales. Registered No: 4396810.

Registered Office:
The Aon Centre
The Leadenhall Building
122 Leadenhall Street
London EC3V 4AN

aon.com

Empower Results®